

**HOUSE OF ASSEMBLY**

**GOVERNMENT BUSINESSES SCRUTINY COMMITTEE**

**Tuesday 30 November 2010**

**MEMBERS**

Ms Archer  
Mr Hidding  
Mr Morris (Chair)  
Ms White (Deputy Chair)  
Mr Wightman

**SUBSTITUTE MEMBERS**

Mr Booth  
Mr Brooks  
Mr Gutwein

**IN ATTENDANCE**

**Hon. Bryan Green**, Minister for Energy and Resources

**Ministerial Office**

**Ms Alison Turner**, Adviser  
**Mr Gary Swain**, Head of Office

**Hydro Tasmania**

**Dr David Crean**, Chair  
**Mr Roy Adair**, Chief Executive Officer  
**Mr Lance Balcombe**, General Manager, Strategy and Finance  
**Mr David Jeffrey**, Manager, Government Relations

**The committee met at 9 a.m.**

**CHAIR** (Mr Morris) - Welcome to the GBEs scrutiny committee.

**Mr HIDDING** - Chair, our spokesman on Hydro is Mr Gutwein and assisting him will be Mr Brooks.

**CHAIR** - Mr Hidding, for clarification, because I am in the chair today, do you have any difficulty with my remaining in the chair while Mr Booth asks questions?

**Mr HIDDING** - That is an interesting concept. That does give you give two people at the table.

**CHAIR** - No, I do not intend to ask questions from the chair.

**Mr HIDDING** - It still gives you two people at the table.

**CHAIR** - In that case, I will have to ask my deputy to chair the committee so that we can do our questioning.

**Mr GREEN** - I would like to congratulate Hydro on the successful year it has had in 2009-10. The business has delivered a strong financial performance for the year, mainly due to the return to average rainfall, and ongoing containment and improved trading opportunities in the National Electricity Market. The business recorded, as we all know, an operating profit of \$72.9 million for 2009-10, and that was up from \$38.6 million in 2008-09, based on turnover of \$726 million. Hydro Tasmania continued to invest strongly in 2009-10 with capital expenditure of some \$95.5 million for the year. Returns to owners in 2009-10 were strong with the business returning a dividend of \$25.5 million, which was a revision to the standard dividend payment formula. Storages are a determining factor with Hydro Tasmania's financial performance. At 30 June 2010, they were 36.3 per cent, up from 27.7 per cent at 30 June 2009 and they are currently sitting at around 47 per cent. This stands the State in good stead for future business opportunity. I think that figure in itself highlights, when you weigh it against previous performances, how important it is to maintain good storages in Tasmania, but at the same time it also allows us to understand, in those drought years the importance of maintaining surety of energy supply to Tasmania.

Notwithstanding all those issues, Hydro Tasmania performed well through 2009-10 but the year was still fairly challenging. The businesses have had to deal with significant sustained scrutiny in Parliament, which is important, and the media and community. Operations and issues associated with their commercial behaviour have been talked about at length, as well as issues associated with electricity prices rising in Tasmania, as they are across the whole of the country. I think the organisation has dealt very well with those issues and I have had a very open and frank relationship with both the chair and the CEO as we have worked our way through those issues. I have great faith that we will be able, if you want to scrutinise any of the issues that I have just talked about, to do that without any problem at all.

This is of course likely to continue as a result of the expert panel that has been put in place and of course we are looking forward to Hydro Tasmania participating fully in that process, as we are with all the energy businesses. I am sure that is going to be a robust committee that will allow us to understand the future of energy delivery and a whole range of other issues associated with energy. I met them recently and had a frank discussion. I was extremely impressed with the way they are conducting themselves so far and I look forward to that work continuing. The message is of course that Hydro Tasmania will be cooperating fully in that process and are in fact looking forward to it.

Hydro Tasmania has some exciting future prospects that will continue to see it being a leader in renewable energy development. That will generate benefits for and have positive impacts on

the Tasmanian community and economy. Musselroe is a good example that we are working towards and of course the Bass Strait islands renewable energy project is an extremely exciting one as well. I am sure that once we get the opportunity to talk about that we will understand the significance of that project, not only from a Tasmanian perspective but for remote communities right around the world, so we do see great opportunities as a result of that project coming on line.

I do want to acknowledge the hard work of the chair, the CEO and the whole Hydro team. They certainly are a professional outfit. They have made some decisions in recent times that I believe set the business up for a strong future and of course the Government has tried to work as well as we possibly can with them to allow them to achieve that success.

**Dr CREAN** - We have had a strong financial performance this year, as the minister has said. That has been on the back of a welcome return to average rainfall and a more efficiently run business with an eye on cost containment. If you look at the major statistics for the organisation, we have had a profit this year of \$72.9 million, which is twice last year's. Our operating cash was well up at \$178 million. Our debt was reduced to \$863 million, a reduction of \$40 million, and this was on a turnover of \$726 million.

The Tasmanian component of the revenue actually decreased because of greater competition, but the interstate revenue increased mainly through the opportunities through Basslink afforded by that welcome return to average rainfall. When you compare this last financial year to the two previous drought years it really did demonstrate the fundamental importance of at least average rainfall to the organisation, and the importance of Basslink. Last year with that average rainfall we saw total flexibility in the use of Basslink. We were able to export into the national market at high prices and import at low prices, which delivered significant value to the organisation. This of course was in stark contrast to the previous two drought years where we were predominantly importing to keep the lights on in Tasmania. In those drought years, that came at a cost in forgone revenue which was borne by Hydro Tasmania at no extra cost to consumers. So you can see over the past three years how Basslink has operated in the way it was supposed to in times of drought, providing security and reliability, keeping the lights on in Tasmania, and the flexibility with exporting at high prices and importing at low prices.

Because of Basslink, Hydro Tasmania is now a much more diversified business. Tasmania is still our main market. It is where the vast majority of our assets lie but we are truly a national and international business. We are a wholesaler and, with the purchase of Momentum, a retailer in the national market. Our consulting division, Entura, has offices in Hobart, Melbourne, Brisbane and New Delhi in India. It is assisting Australian States and parts of Asia in developing renewable energy in dealing with water catchment management issues. Our business development arm - Roaring 40s, the wind development company, which is 50 per cent China Light and Power but was developed by Hydro Tasmania through business development, is now about to commence on King and Flinders islands the development of renewable energy solutions which will have ramifications for remote area power supply in any regional community throughout the world.

We do see a bright future for Hydro Tasmania. It is Australia's largest renewable energy business, Australia's largest manager of water, and is right in the middle of climate change and its consequences. It is always gratifying to know that a business such as this can produce a profit while contributing significantly to social and environmental outcomes in some of the underdeveloped parts of Asia. We are assisting in developing renewable energy. We have remote area power supply being developed, which we hope we can take to regional communities in Australia and Asia.

Of course we have had a significant input into the International Hydro Association protocol, a comprehensive protocol dealing with economic, social and environmental aspects with any new hydro development throughout the world. When you look at Asia and southern Africa, where there are hundreds of thousands of megawatts of potential hydro development, this must be developed over the next 30 or 40 years if we are going to increase renewable energy worldwide and try to put a brake on dangerous greenhouse gas production.

Our future strategic direction is about financial consolidation. It is about growth in the National Electricity Market through our retail arm and about growth in service provision through Entura Consulting and through business development. Tasmania is still our main market; most of our assets are here but we do see value being added to the business and therefore to the people of Tasmania by growth in the national market.

**Mr GUTWEIN** - Hydro is a renewable energy generator. We were talking before in regard to the comment made the last time you were here that rain of biblical proportions was needed, but I want to go to the other arm of Hydro - wind. In the report you make the point that Roaring 40s has faced challenging conditions but you also make the point that the wind you expected was lower than expected and that you have had to downgrade revenues in the future as a result. Could you explain what that means? In the context of Roaring 40s having run at an operating loss now for the last five years, could you give some indication as to what you see happening with the revenues of that company in the future?

[9.15 a.m.]

**Dr CREAN** - Yes, there have been operating losses but this is a relatively new business, a growth business. We have built up significant assets within the business, several hundred million dollars of assets, half of which are ours. There is that opportunity at some time in the future to take some of that equity out by taking new equity in that. So that's a possibility but because we are continuing on a path of wind-farm development, most of that equity would be going into developing new wind farms such as Musselroe.

We see a gradual improvement in the operating performance of this company but bear in mind we are building up significant capital. We saw that even in China. When the Howard Government decided not to continue the Renewal Energy Target Scheme we went to China and developed a number of wind farms and then sold out at a profit. I think that demonstrated in a relatively short period the build-up in equity that can result.

Yes, the wind speeds have been disappointing but they are variable and we have to manage that within the operation of the business, but we do see a very bright future for our involvement in wind farms.

**Mr GUTWEIN** - Can I ask you about modelling on that? I note from the report that you have said that lower than expected wind speeds are of particular concern as they will potentially have a long-term impact on profitability and that Roaring 40s have conducted a review of forecast energy output and consequently reduced forecast figures by between 8 per cent and 14 per cent.

I wanted that question answered on the basis of the fact that this year Roaring 40s lost \$13 million - an operating loss. The previous year it lost almost \$8 million, the year before that \$6 million, \$2 million the year before that and in 2005-06 a loss of \$7.5 million. There are no forecasts in the annual report as to when you will see operating revenues exceeding expenses.

Could you explain when you think that Roaring 40s will return a profit? And with the reduction of 8-14 per cent in wind, how serious is that? Obviously it is a serious issue in that you raised the matter in your annual report, but for what period are wind speeds not to be what you would expect? If David Llewellyn was sitting across the table we might ask him to pray for rain in biblical proportions but what do you do about wind if it doesn't blow?

*Members laughing.*

**Mr GREEN** - We are in the roaring 40s, hence the name. It is likely to blow in future.

**Dr CREAN** - It is blowing but it not blowing.

**Mr GUTWEIN** - Well, you have reduced your forward Estimates by between 8 per cent and 14 per cent. So how serious is this and when do you expect the company to produce a profit?

**Mr ADAIR** - I will answer the latter question first. We are on target this year to break even and our whole operation is focused on a realistic estimate of energy yield, and energy yield is a function of the wind regime. So let us go back to the question of the cost. In terms of the operating cost base we are looking to refine that whilst at the same time recognising that we are developing projects and those development projects are clearly charged and expensed in this year.

**Mr GUTWEIN** - Just on that, you said 'refined your cost base'. I note that you refined your cost base in the previous year by about \$16 million, the operating expenses were reduced by -

**Mr BALCOMBE** - That would reflect the removal of the China business.

**Mr GUTWEIN** - Okay, so that is China coming out?

**Mr BALCOMBE** - Yes.

**Mr GUTWEIN** - When you say 'refine' what do you expect to do?

**Mr ADAIR** - We are looking at the total operating cost base - what our operation and maintenance costs are and clearly the supervisory costs involved on each of the sites. We are seeking to rationalise them so that we have a cost-effective operating base. We obviously have to ensure that the assets are fit for the purpose so they can take advantage of the wind yields. I think we are happy that the overall performance of the assets in terms of their availability - that is that when the wind does blow the turbines are capable of generating and earning revenue, so availability factors have been consistent with our investment expectations. That is a function basically of the data that was available at the time of evaluating these wind sites and also a function of the fact that we have had a couple of low wind years and we have also had lower-than-expected energy prices. It is also a function not only of the volume but also of the price we get for that energy. So that gives us our total revenue. We have had a good look at both the cost base and the energy yields and we now have a prudent forecast for the wind deals. We are confident that this year will produce a break-even position and we are looking forward to building on that in future.

**Mr BOOTH** - How did you get the modelling so wrong? You obviously built the stations on the basis of the wind modelling that you had. Who did that wind modelling and why has it not performed to that? Was the modelling wrong?

**Dr CREAN** - No. What we do is collect 18 months of data. That is an accepted standard and that is what we did. That is what the wind speed showed with that data. Of course, wind varies as rainfall varies as a result of climate change -

**Mr BROOKS** - Or climate.

**Dr CREAN** - Yes, climate, but climate change can become variable too. We expect that, just as we have had a drop-off over the several years of operation, it may improve in the future with the variability. You look at our rainfall and wind can follow that path as a result of the change in the climate.

**Mr BOOTH** - Yes, but the point I am making is that obviously your predictions are that you will suffer this 8 per cent to 14 per cent, or whatever it is, drop.

**Mr BALCOMBE** - I suppose there are a couple of elements to wind forecasting. The first thing is that some of these wind sites were developed in early 2000 and when you have a bare site you have to stand up a couple of masts and then you have to take correlations and if you look at what we did up on the north-west coast we also correlated to the CSIRO site. But it was based on the modelling technology that we had at the time. So it is always an estimate when you do this. It is always a model and it is always correlated.

**Mr GUTWEIN** - So were there flaws in that model?

**Mr BALCOMBE** - I would not say so much flaws, I think the technology has changed. So it was based on the available technology at the time. So with 20/20 hindsight you could draw the conclusion that it is flawed but it was based on the available technology at the time.

**Mr BOOTH** - Surely it is not rocket science -

**Mr BALCOMBE** - Am I able to finish?

**Mr BOOTH** - You did not let me finish but I will give you that indulgence.

**Mr BALCOMBE** - I am not sure whether it is rocket science but it is certainly complicated mathematically. It is a model complex done by engineers.

**Mr BOOTH** - So has the modelling changed since 2000?

**Mr BALCOMBE** - The basis of modelling has changed and the technology has changed. The other issue is, once you have a wind farm standing, you have a lot more data because you have monitoring on every tower, so you can obviously get a more accurate reflection.

**Mr GREEN** - Can I say that the work that has been done, for example on Musselroe, allows us to understand that it is absolutely prudent to be considering building a large-scale wind operation at Musselroe, just as it is for the people looking at Cattle Hill in the centre of Tasmania. They have their towers up now, checking wind speeds, and it is about them making a commercial decision as to whether or not the opportunity exists for wind generation in Tasmania. But issues associated with whether the wind blows hard and velocities are very difficult to predict. That does not mean that the policy on wind generation should change.

**Mr BOOTH** - With respect, Minister, the point is here you have a major investment. You have nearly \$40 million worth of losses attributed to the various projects. I don't want to criticise - obviously it is good to try to develop some other generation system. But if the modelling was flawed it obviously totally wrecks your business case. It will wreck your ability to sell some of those assets that you are talking about getting equity investment in. That would be based on what you are able to put out and not put in. People will not pay much for something that has lost \$40 million for a period of time, so it reduces your asset value and puts public money at risk. As to that modelling, surely you don't go out and stick your finger up and feel the wind and say, 'She'll be right'.

**Mr GREEN** - No, no.

**Mr BOOTH** - But your modelling is so bad, shouldn't you have -

**Mr ADAIR** - I will answer this point in several parts. First of all, this was an estimate made at the time of making the investment. At the time we were using the best available predictive tools, and in terms of the technology of those, they have improved. As you say, it is not rocket science. You are basically looking at the wind yield, you have calibration against Bureau of Meteorology sites, CSIRO sites and, as far as possible, you are looking at a ray loss and how many wind turbines you can get on there to optimise the energy yield from the utilisation of those turbines.

**Mr GREEN** - Was the windshear factor right?

**Mr ADAIR** - Yes.

**Mr BOOTH** - Except that it was wrong. That's the reality, it was wrong.

**Mr ADAIR** - No, the original assumptions about it, shall we say, did not prove to be realised.

**Dr CREAN** - The important thing here is that in the business case you do a probability of the wind speeds being as recorded and you do deviations from that probability. We go through all that in the detailed business case and even if there is a drop of 10 per cent in the wind speed, that would probably alter the internal rate of return from about 15 per cent.

**Mr BALCOMBE** - I was trying to make the point that on the Woolnorth site it is higher than that. When we first analysed those business cases on the north-west coast they were in the early 20s from an IR perspective, and with the revised wind estimates they still sit in the high teens, so they're still very positive.

**Dr CREAN** - So it's a very strong business case. Don't pick on one thing - this is a strong business case.

**Mr GUTWEIN** - No, we're not picking on it. The annual report states that there has been an 8-14 per cent drop in the volume of wind and that will flow through to internal revenues. If it wasn't serious, with the greatest of respect, you would not have included it in the annual report.

**Dr CREAN** - No, but we have to; it's a material thing.

**Mr GUTWEIN** - That's exactly right, it will materially affect you.

**Mr GREEN** - And as the CEO said, we are getting back to break-even this year.

**Mr GUTWEIN** - What will it do for revenues? If you were forecasting revenues before you had to make this 8-14 per cent adjustment, what does it mean in dollars and cents? What are we losing in regard to revenues moving forward?

**Mr ADAIR** - Can I answer that question in a slightly different way?

**Mr GUTWEIN** - I'll wait until I hear the answer.

**Mr ADAIR** - Okay. It is basically looking at the value of the assets. I think the chairman and Lance have answered, saying that the expected rate of return from these wind farms, and Woolnorth in particular, will be in the region of 13-14 per cent. That is an internal rate of return. We believe that is an excellent rate of return from wind farms and therefore it means that we are getting a positive return on the capital invested in those wind farms. Why you get a loss at the time is also about the level of project finance you're using and the level of interest that you have to pay. Clearly, project finance terms are very aggressive in terms of the period of debt you can have and therefore we are seeing an increase in interest rates at the moment and all of those impact upon the overall profitability. Looking at the rate of return, that is an acceptable rate of return for a wind farm. I think most wind farm developers would be delighted to have those rates of return.

**Mr GUTWEIN** - Very good - so I'll come back to the question I asked: what is it costing you? What loss of revenues have you forecast as a result of this downgrade?

**Mr ADAIR** - Well, we're not forecasting a loss of revenues. As I said, this year we will break even.

**Mr GUTWEIN** - No, I'm sorry, but with the greatest respect, if you downgraded the output from your assets because the wind is not blowing as you expected it to, there would have to be a reduction in revenues, would there not?

**Mr ADAIR** - There is a reduction in revenue.

**Mr GUTWEIN** - Thank you. What amount is that?

**Mr ADAIR** - I'll come back to you and take that question on notice.

**Mr BALCOMBE** - The way we budget for revenues coming out of Roaring 40s is by way of dividend. Roaring 40s is a separate company to Hydro, so from a Hydro Tasmania perspective we budget on getting dividends over the corporate plan period. As that business has been growing, we haven't been budgeting any dividends because we are reinvesting the capital. If we take it out by way of dividend and put it back in there is no benefit in that, we just churn the money through Roaring 40s.

**Mr BOOTH** - But you are actually investing in losses; I mean, you've lost nearly \$40 million.



**Mr BALCOMBE** - No.

**Mr BOOTH** - Well, that's what the figures have stacked up to over the last five years.

**Dr CREAN** - This happens with any growing business because we have an operating wind farm and then we are developing new wind farms that are not operating but are requiring capital, so that is included in the expenses and that is why the expenses are higher than the revenue. When you get a number of wind farms that are actually operating over and above the cost of the capital that you are putting into new ones, that is when you start to get an overall profitability, and we expect that to happen over the next couple of years.

**Mr BOOTH** - Well, you would be capitalising those costs; if they are not completed farms they would not come into your ledger as a loss, they would come in as an asset - unless you have an interesting accountant - and I wouldn't mind having him!

**Mr ADAIR** - No, depending on what you have -

**Mr GUTWEIN** - I think that is a fair point. I'm just looking at page 122 and the expenses for Roaring 40s this year were \$50 million.

**Dr CREAN** - That is right.

**Mr GUTWEIN** - Did you provide a breakdown of those expenses? Can we have a look at what the operating expenses are and what the capital is?

**Dr CREAN** - That includes development costs of expenses of new wind farms.

**Mr GUTWEIN** - That is the point - can you break it down for us, please, so that we can get an understanding?

**Dr CREAN** - Well, we can get it for you but that is what it is.

**Mr BALCOMBE** - I don't have it available today.

**Dr CREAN** - It's not that these wind farms are producing \$37 million and are costing \$50 million to run. The wind farms that are producing are the ones that are up and running but the costs, the \$50 million, includes development costs for new wind farms that are not producing anything, and that is the point.

**Mr BOOTH** - How come you are not capitalising them, then? You can't write off the cost of construction or something as an operational loss on another -

**Dr CREAN** - These are development expenses. They're current expenses.

**Mr GREEN** - And the Government encourages it.

**Dr CREAN** - We have a workforce to pay while it is building a wind farm that isn't producing any wind.

**Mr GREEN** - You've been on our back about building Musselroe. Do you want Musselroe or not?

**Mr GUTWEIN** - We're not arguing about the fact that this is a development company. We are simply asking for a breakdown of that \$50 million and -

**Dr CREAN** - We can do that, but I'm answering Mr Booth. He was saying why don't we capitalise it but it is not about capitalising. These are development expenses that are listed in that \$50 million that are equated with wind farms that are not built.

**Mr BOOTH** - In general like research and development stuff across the whole -

**Dr CREAN** - Well, paying the workforce.

**Mr BOOTH** - Perhaps to narrow it down in the question, with regard to, say, Woolnorth, you are talking about up to 14 per cent in value terms, so what does that mean in terms of the business case then just for Woolnorth, setting aside all those other costs that you are amortising across the business?

**Dr CREAN** - As I said in the business case, we do the probability of getting the internal rate of return and even with a reduction in wind speed it is still a very good rate of return.

**Mr BOOTH** - Woolnorth itself?

**Mr ADAIR** - Yes, in excess of 12 per cent.

**Mr GREEN** - From what I understand it is one of the best wind sites in the world.

**Dr CREAN** - Yes, it is one of the best.

**Mr BOOTH** - If you're talking about driving down costs and trying to get the business case working by cutting some of your costs, what sort of job losses are you looking at there?

**Mr ADAIR** - We are not looking at job losses, we are looking at the incidental costs that we incur around those operating costs. Our aim is to ensure that we have an efficient operating cost base, so we are looking at cutting down all incidental expenses associated with it.

**Mr GUTWEIN** - So have you been wasting money?

**Mr ADAIR** - No, we have not been wasting money.

**Mr GUTWEIN** - Well, it's a reasonable question.

[9.30 a.m.]

**Mr ADAIR** - The issue here is you always look at basically how much it costs to support these wind farms, and we see primarily with regard to the O&M contracts that we have in place and most of these are with the original equipment manufacturer and we seek to garner economies from those when the contracts come up for negotiation.

**Mr GUTWEIN** - This refinement that you spoke about a few questions ago, what level of refinement will this have on your operating cost base, do you think? Are we talking millions of dollars of potential savings?

**Mr ADAIR** - Yes, it will be millions of dollars.

**Mr GUTWEIN** - Why has it only been picked up now that you are in the chair?

**Dr CREAN** - Can I just say that this was also tied in with exiting China. We built up quite a significant backing to manage the wind farms in Australia and in China. We exited China and China Light and Power purchased the Chinese assets, so it became Roaring 40s Australia, and we had noted the development in costs when we separated the Chinese wind farms from the Australian operations. The previous CEO agreed with the General Manager of China Light and Power in Australia that we would look at the cost structure of Roaring 40s and we have been progressively reducing costs. As the CEO has said, when he came on he picked up that mantle as well and, as he has indicated, he will continue the cost reduction.

In reducing costs in the business, whether it be Roaring 40s, development of wind farms or Hydro Tasmania in general, we have produced this strong performance in part because of the rainfall but also in part because we have had a strong eye on the cost structure of the business. You have to do that - as Mr Brooks would know - in the private sector; looking at the most efficient cost structure that delivers you the outcomes you require.

**Mr BROOKS** - But I normally would not include my capital expenditure in my operating expenses; I meant profit and loss.

**Dr CREAN** - No, no, I didn't - the operating expenses are the operating expenses. They are the workforce. It includes your workforce, is that right, Mr Brooks?

**Mr BROOKS** - Yes.

**Dr CREAN** - Includes your workforce in your operating expenses.

**Mr GUTWEIN** - Just on that point, do we need to put questions on notice? We had a nod before on the effect on revenues of the 8-14 per cent reduction in wind in 2010 and over the next three to five years, and then a full breakdown of the operating expenses of Roaring 40s?

**DEPUTY CHAIR** - You need to present them in writing to the secretary.

**Mr GUTWEIN** - Can we get those during the course of the committee today?

**DEPUTY CHAIR** - The process is that you hand them in writing to the secretary.

**Mr BOOTH** - So with regard to the modelling for Musselroe, you have that fairly disappointing result. In a sense you are lucky that Woolnorth is producing 10 per cent or 12 per cent, which is adequate, I suppose, though only just. You would not want the price to drop any more or the wind speeds to drop off any more than they have done. You are saying that was not because of faulty modelling but that it was the 'best modelling that was available in 2000'. So what are you doing about the models that you have used to underpin Musselroe?

**Mr GREEN** - From a policy point of view the Government believes that Tasmania has an extremely good wind resource available to it -

**Mr BOOTH** - But just because the Government believes there is a strong wind that means nothing.

**Mr GUTWEIN** - Except that you modelled for a gale and you have ended up with a breeze.

**Mr GREEN** - No, not at all - that is simply not true. Your trouble is that you have fallen into his trap.

**Mr BOOTH** - No, you fell into my trap.

**Mr GUTWEIN** - No, no, don't lecture me. With the greatest of respect -

**Mr GREEN** - Hang on.

**DEPUTY CHAIR** - Order, the minister has the call.

**Mr GUTWEIN** - I don't need to be lectured by you.

**Mr GREEN** - I am not lecturing you, but the point I am making is that you have done your best to talk the State's economy down overall and now you are doing it to the wind resource in Tasmania. Realise this -

**Mr GUTWEIN** - Point of order, we have an annual report sitting in front of us, which clearly states that the wind resource is not what this company expected it would be, and now we have the minister going on talking about talking down the economy and a whole range of things.

**DEPUTY CHAIR** - The minister can answer the question however he sees fit.

**Mr GREEN** - It is not a point of order and if you would indulge me for a couple of moments without being so rude -

**Mr GUTWEIN** - I don't think I am being rude.

**DEPUTY CHAIR** - If you give the minister the opportunity he will answer the question quickly and then you can ask another one.

**Mr GREEN** - It has been explained to you already that the drop in prediction still leaves us with a world-class wind resource, which includes Musselroe. Now in the early days of the development of Musselroe there were some technical issues about windshear and the direction of wind and a whole range of issues, but technology has allowed us to work through those issues, particularly in relation to windshear and get it to a point where the site is deemed to be an extremely good one.

**Mr BOOTH** - Right, now will you answer the question I asked?

**Mr GREEN** - Yes, the modelling allows us to understand that Musselroe is an extremely good prospect for us, and in fact in future we would want to - we are constrained in developing wind in Tasmania for various reasons -

**Mr BOOTH** - Yes, I understand they are not all your fault.

**Mr GREEN** - and we want to be in a position to fully develop the wind opportunities. I would have thought you would encourage Hydro. They have been honest about a drop-off in predictions but -

**Mr BOOTH** - I am just asking a question to try to get to the bottom of the modelling, Minister. This is ridiculous.

**Mr GREEN** - It is not ridiculous.

**Mr BOOTH** - It is ridiculous. It is a simple question, what is the modelling?

**DEPUTY CHAIR** - Order.

**Mr GREEN** - It is not ridiculous. I am simply making the point overall because you want to leave the Tasmanian community thinking that the wind resource in Tasmania is not good and we have bungled that. That is not true. It is a world-class resource that we want to continue to develop. I am putting that on the record.

**Mr BOOTH** - That is what you said about forestry and you said about -

**Mr GUTWEIN** - There is no need to be so defensive.

**Mr GREEN** - I am putting on the record that it is a world-class resource that we want to continue to develop.

**Mr BOOTH** - According to the minister.

**Mr GREEN** - In the face of opposition from the Greens, that is okay - Mr Booth's anyway. We want to continue to develop it.

**Mr BOOTH** - Just keep making it up.

**Mr GUTWEIN** - I am just trying to understand what this means to the company moving forward. I think that is a very reasonable thing.

**Mr BOOTH** - I would like to just re-put that question because it is a pretty reasonable question. The assumptions on Woolnorth have not proven to be what they were, so now I want to know if you have gone back and ground-proofed the assumptions for Musselroe or will we see the same situation?

**Mr ADAIR** - If I might answer that, I would like to first of all make clear that the return on Woolnorth is still a very attractive return and it is an economically attractive site. So although the wind yield has not been as was originally modelled we have conservatively, as you would do with

prudent management, looked to using the latest wind forecasting tools to see what the yield would be on that basis.

**Mr BOOTH** - Not on Musselroe?

**Mr ADAIR** - No, this is on Woolnorth. I am going to extrapolate then on to Musselroe very shortly. So that still leaves us with a very healthy return, which means that it is a positive economic investment and will produce an acceptable return for the funds that have been outlaid on that score.

I would add as well that there has been no impairment to the asset value because if we were really concerned about that in terms of its value we would have impaired the asset value. So there has been no impairment of the asset value.

**Mr BOOTH** - But there is a difference between you impairing the value and what a market entrant might pay for it.

**Dr CREAN** - Just on that, Bluff Point - 13.6 per cent return on equity, Studland Bay - 11.8 per cent return on equity. That is with the change in the wind speed. So it is still a very commercial operation. In terms of Musselroe -

**Mr ADAIR** - In terms of Musselroe we have clearly taken the latest forecasting capability, calibrated that and made sure that we have a robust wind assessment. We have taken it at different levels of probability and therefore the investment case will also take into account the downside scenario of what would happen if the wind were out by 10 per cent and therefore do we still have a feasible investment. And that is what you would do as a prudent investor.

**Mr BOOTH** - Sure, I totally support that so where are you with it at the moment as far as the business case for Musselroe goes?

**Mr ADAIR** - As far as the business case for Musselroe goes if we can realise the contract prices that we are hoping for from our initial estimation, we then believe that we have a project that is worth making a financial investment decision and we expect to be in that financial investment decision by the end of Q1.

**Mr BOOTH** - With the business case for Woolnorth, setting aside pressure from government in regard to policy or whatever, but just in a pure business case sense, to make an investment you would not have made it with a probability of 10 per cent or 11 per cent? The original projections would have been 18-20 per cent, would they?

**Mr BALCOMBE** - Probability or internal rate of return terms?

**Mr BOOTH** - Internal rate of return.

**Mr BALCOMBE** - It was in the high teens when we did it.

**Mr BOOTH** - You would look at it and say, 'That looks like a goer, we will do it.' But you probably would not do that if there were variability on a 10-11 per cent rate of return, would you?

**Mr BALCOMBE** - I might just explain development of a business case. There are a number of layers to it. Ultimately these wind farms get project finance, so in essence what happens is a model is developed for the wind and a model is developed for the business case. When you project-finance it, you end up with an agreed model with the banks. So from the point of view of a validation, if you were to take the Musselroe business case, Roaring 40s will have its own modelling done, it will have a check on that. So it could be that Entura - Hydro Tasmania's consulting business - does the modelling for Roaring 40s. It is likely that that would then get checked off by another firm such as Garrad Hassan, so we get some validation on that modelling -

**Mr BOOTH** - They do their own data production?

[9.45 a.m.]

**Mr BALCOMBE** - They use the same source of data because you only have one set of wind towers and monitoring towers on the site. From the point of view of the probabilities that you assign to wind, you can use various probabilities. You could use a P50, P80, P90 or a P100. An adverse case under the financial scenarios is P90, so only one year in 10 can be worse than what you have as your modelled outcome.

As part of that process you do the P50, P80 and P90 probabilities on the wind; you then hand those models across to the banks and they then do their own independent assessment of that. So the banks might use another consultant, such as PV Power. We have done projects at the Roaring 40s level through the NAB, and they generally use PV Power. So you have three independent points of validation on that wind but you also run the business case at a higher probability. In general, at the Roaring 40s level we try to model P80 and try to get the wind farm to get a hurdle rating of around 11.5-12 per cent of that P80 probability. You build in some downside against that business case to start with, so it is set at a conservative basis.

**Mr BOOTH** - Given that the minister said that Woolnorth is the best wind site in the world and it underperformed on the figures, is it something that you are taking pretty seriously in terms of the risk assessment with that investment?

**Mr BALCOMBE** - It is your fuel. If you compare it to Hydro, wind is your fuel for a wind farm, obviously, but you have to do a lot of work to try to validate that.

**Dr CREAN** - The other point to make is that in its first year of operation it exceeded the data. The last couple of years it hasn't -

**Mr GUTWEIN** - So was that a fluke?

**Dr CREAN** - No, it is the variation. I would suspect that in two years' time when we are back in the committee, it may even be back to that. It is a variability. This is over the life of 20 years of a wind farm. What is important is the average wind speed over the life of that wind farm in terms of the financial return.

**Mr GREEN** - Let me summarise. What we have gained is that there is no write-down on the asset value.

**Mr BOOTH** - No, what we have gained is that it is not worth as much to a network partner.

**Mr GREEN** - We understand that, and we are getting a good rate of return. There are two things and we have a world-class resource.

**Dr CREAN** - It's based on the return.

**Mr BOOTH** - To get in an equity partner, that would be based on the return, therefore if the modelling had been 14 per cent better you would be able to sell it for more in equity.

**Dr CREAN**- Except they will take the view that this is a 20-year project; they will look at the first year and they take a whole lot of things into account. This is a very substantial asset for the organisation.

**Mr BOOTH** - Yes, but logic dictates that if it is producing more you will get more value out of it if you sell the share. In this case, because the model hasn't been achieved, then you would effectively have less than its notional value if you were going to sell it.

**Mr GUTWEIN** - How serious is this? It is included in the annual report and disclosed as something that will affect Roaring 40s in a material sense, so how long has the wind not been what you thought it would be and what are the expectations from the company? When you start talking about it having a potential impact on long-term profitability, did you get the modellings so wrong that this is going to have a material effect over a number of years?

**Mr ADAIR** - No. This is very simply looking at the facts to date. In the course of the year we have checked the modelling arrangements. We have checked them from two different sources and as a result we have come up with a different forecast of the estimated energy yield. As a result of that, all we are flagging, as we would do in the transparency of this reporting, is that there is an expectation that revenue levels will be less than we originally expected in the investment case. The most important perspective here is: would you still make this investment? The answer is an emphatic yes, because it still offers a very attractive rate of return -

**Mr GREEN** - As will Musselroe.

**Mr ADAIR** - and is more robust. The point is we now have a very robust forecast in terms of the ongoing economic performance of this wind farm.

**Mr BOOTH** - So is the wind speed data wrong or are you using a different model in terms of what you would actually yield out of it? Was the yield analysis wrong or the wind speed analysis, or recovered yield out of the turbine? Is that the problem?

**Dr CREAN** - It is a combination of things, but at the time it was monitored the speed was different because of variability. As Roy and Lance have explained, the technology used in establishing the data is different.

**Mr GUTWEIN** - Can I ask you about Cathedral Rocks? In the annual report there seems to be a significant downgrading in revenue and expenses; is that an accounting issue? What is occurring?

**Mr BALCOMBE** - Cathedral Rocks Construction & Management is the company that Hydro Tasmania incorporated to undertake the construction of the Cathedral Rocks wind farm, so it was the EPC contractor. Effectively what you are looking at there is the tail end of that



company completing that EPC contract. So basically it built it; it has a defects liability period, it will tidy a few things up if defects come out, and then it will be wound up. It is likely that will occur this financial year.

**Mr GUTWEIN** - So over the course of building that project, what was the net profit for Hydro as a result?

**Mr BALCOMBE** - I cannot really recall, but I am not sure that there was a profit in it. Hydro Tasmania developed that business case and then we partnered with Acciona to undertake that wind farm; that wind farm was constructed by CRCM and it was subsequently sold into Roaring 40s. I am not sure there was a great deal of margin on that on the basis that we garnered the value in the sell-down through to Acciona, as opposed to doing it through the EPC contract.

**Mr GUTWEIN** - What involvement will Roaring 40s have with Cathedral Rocks into the future?

**Mr BALCOMBE** - It is a 50 per cent owner of it. It is not a 50 per cent owner of Cathedral Rocks Construction & Management. There is Cathedral Rocks Wind Farm Pty Ltd, which owns the wind farm. Cathedral Rocks Construction & Management built the wind farm for the wind farm owner.

**Mr GUTWEIN** - So where then would the operating revenues of Cathedral Rocks, of which Roaring 40s is a 50 per cent -

**Mr BALCOMBE** - Fifty per cent of that would be reflected through Roaring 40s.

**Mr GUTWEIN** - So that would be included in the \$37 million?

**Mr BALCOMBE** - Yes.

**Mr GUTWEIN** - What sort of revenues are coming from Cathedral Rocks? Is that a profitable wind farm?

**Mr BALCOMBE** - No, I would have to say it has had its problems. It has had low wind resources.

**Mr GUTWEIN** - Low wind again?

**Mr BALCOMBE** - If you think about where wind comes from, it comes from the west.

**Mr BOOTH** - But you are the guys who decided to put it there so you should have thought about where the wind came from in the first place. It is blindingly obvious, isn't it?

**Mr GUTWEIN** - So Cathedral Rocks is running at a loss?

**Mr BALCOMBE** - It has been, yes.

**Mr GUTWEIN** - Is that because of wind or problems associated with the build?

**Dr CREAN** - Mainly problems associated with the build. There were problems with the gearbox of the turbines, problems with geography, windshear -

**Mr BOOTH** - Geography - like the location of the turbines?

**Mr GREEN** - Yes, how far back they are from the coastline, and the windshear.

**Mr GUTWEIN** - When do you expect it to return a profit?

**Dr CREAN** - It will go close this year.

**Mr GUTWEIN** - What sort of operating losses has it been building up?

**Mr BALCOMBE** - I do not have that to hand.

**Mr GUTWEIN** - Can we get that information?

**Mr BALCOMBE** - Yes.

**Mr GUTWEIN** - I wanted to ask a couple more questions regarding associated entities. Roaring 40s is running at a loss, and we will get some information in regard to that.

**Mr GREEN** - Yes.

**Mr GUTWEIN** - Looking at the control entities - and I am on page 119 - and Bell Bay Power Pty Ltd, I understand that you have increased the provision for demolition quite significantly, by about 50 per cent, so the provision is now \$18 million? Why has that gone up?

**Mr BALCOMBE** - There are a couple of elements to that. The first point is that when we originally made the provision we were more expectant of obtaining more for that power station from a scrap perspective and it was also based on preliminary estimates at the time of what it took to dismantle that. So the control of the dismantling of that power station has been handed across to our business development team and they have engaged some engineers to do a more accurate assessment of that. I suppose there are a couple of layers to this dismantling. There is the power station itself and as well as that there is the jetty and there is a lot of extra cost in dismantling the jetty than we originally estimated when we first looked at that. So prudently we raised the provision once we had firmer estimates on that.

**Mr GUTWEIN** - Okay, so \$18 million to get rid of that. I note from the Auditor-General's report that Lofty Ranges generated a small net profit?

**Mr BALCOMBE** - Yes.

**Mr GUTWEIN** - Do you expect that net profit to grow?

**Mr BALCOMBE** - It will grow in South Australia. Lofty Ranges is a joint venture we have with SA Water that runs a mini-hydro and pump storage operation. It's a small project and it has been delivering small profits, but one of the things we undertook in this current financial year is an assessment on the eligibility of that project for RECs because it's a pump storage, so basically what happens is that the water gets pumped up overnight. Our original view was that it would be

ineligible to generate RECs but we approached the officer of the Renewable Energy Regulator and he subsequently found that pump storage operation is eligible for RECs, so it will generate some larger profits this year.

**Mr GUTWEIN** - So are we talking about hundreds of thousands of dollars?

**Mr BALCOMBE** - Yes, probably in the hundreds of thousands, but it's a positive little operation.

**Mr GUTWEIN** - That's a positive, Minister - heading in the right direction. What about Entura, or Hydro Tasmania Consulting? That has run at a loss, is that right?

**Mr ADAIR** - Last year, yes.

**Mr GUTWEIN** - Why?

**Mr ADAIR** - Primarily, that was the result of the global financial crisis and the slow ramp-up rate of the client customers. If you look at the client customers, they are utilities that have been adjusting their plans and are only now beginning to ramp up to levels of pre-GFC expenditure.

**Mr GUTWEIN** - So you expect Entura to come back with a profit?

**Mr ADAIR** - Definitely. It is a business that we run so that it is a profitable entity. It is expected to generate profit.

**Mr GUTWEIN** - So will that generate a profit this year?

**Mr ADAIR** - It will at least break even this year.

**Mr GUTWEIN** - That's better than not.

**Dr CREAN** - If you go back to pre-GFC it was making a net contribution of around \$4 million and was doing very well and then, like everything, work just dried up. So we expect that it will be getting back to at least that level as we move forward.

**Mr GUTWEIN** - So where is Momentum at?

**Mr ADAIR** - Momentum as a retail business is growing well. It made a slight loss last year but you would expect that in the process of a growing retail business.

**Mr BOOTH** - Have any of them made a profit?

**Mr GUTWEIN** - We have Bell Bay power that is \$18 million in the hole, Lofty Ranges is just making a little bit of a profit, and then away we go.

**Dr CREAN** - But you forgot about the Hydro, which made a record profit. That's important, it's the main part of our business.

**Mr GUTWEIN** - And the tail doesn't wag the dog but at the moment the tail's costing a fair bit, isn't it?

**Dr CREAN** - Momentum is a good example. We went into retail in the national market because, as a wholesaler in the national market we had to remain competitive, otherwise the wholesale margin would have been squeezed and, in part, because we're a renewable energy supplier, it has been a very attractive proposition for customers and is growing strongly. Because it was a small business to begin with and is growing rapidly it has growth costs associated with it but in spite of that, we expect it to break even this year and to generate increasing profits in subsequent years. That is how confident we are about that business.

[10.00 a.m.]

**Mr BOOTH** - So you bought the retailing thing effectively as a buffer so you could mop up surplus wholesale power that you couldn't sell in the NEM - you effectively bought it yourself?

**Dr CREAN** - It was an opportunity to progress our renewable energy sales at a different level but most importantly it was a competitive response because, had we just been a wholesaler in the national market, with your AGLs and your Origins that are vertically-integrated wholesale and retail - the very strong players in the national market - we would have been squeezed. So we have this opportunity with wholesale and retail now to be more competitive in the national market.

**Mr BOOTH** - Isn't that a bit counterintuitive to the whole thrust of disaggregation and not having vertical integration to introduce competition and so forth? It seems to be against the whole reason that Hydro assets were disaggregated in the first place. Do you have a position as a board with regard to reaggregation?

**Mr ADAIR** - Let me say that in the development of merchant risk markets around the world the model is that you have vertically-integrated players, because the whole disaggregation across the world has been on a model that generation is merchant risk, transmission and distribution are monopolistic regulated entities, and retail is merchant risk and therefore what you don't want to be is completely low on generation and short on sales, so you need to have a sales capability. We have both a physical and a financial hedge provided by that. Vertical integration is a natural risk management arrangement. It is the trend around the world and, as we have seen, within the National Electricity Market in Australia vertical integration has taken place and the biggest exponents of that were Origin, AGL and TRUenergy and now we will probably see that with International Power being taken over by GDF Suez.

**Mr BOOTH** - The question was: do you as a board have a position in terms of reaggregation of the original Hydro assets - Hydro, Transend and Aurora - and why wouldn't you, given that what you have just said seems to be completely contradictory to the reason for disaggregation in the first place?

**Dr CREAN** - We're talking about generation retail, we're not talking about transmission and distribution.

**Mr BOOTH** - Well, if you reaggregated Aurora and Hydro how would that go?

**Dr CREAN** - That's not up to us. We're a generation company. We have a retail business and we're developing that business very comfortably.

**Mr BOOTH** - But that would be a great way to get some vertical integration, wouldn't it, to take over Aurora and pull them back in under the doona with you?

**Mr GREEN** - No. The important point to make here is that, with both of your help we have set up an expert panel to look at a whole range of issues associated with the structures of the energy businesses.

**Mr BOOTH** - I'm asking for a view that could inform the debate.

**Mr GREEN** - Yes, I know you're asking for a view.

**Mr BOOTH** - I know you don't like that.

**Mr GREEN** - Well, you make your contribution to the committee and they will make their contribution to the expert panel and we will see what comes out at the other end. The important part about that is you want to foreshadow the debate with respect to that.

**Mr BOOTH** - No.

**Mr GREEN** - I would suggest to you that you'd be better off keeping your powder dry and talking to the expert panel.

**Mr BOOTH** - I'm actually talking to experts here to find out if they have a view because the Chair has talked about vertical integration being necessary for the business model and the -

**Dr CREAN** - For generation retail, that's all - and the CEO explained that it is a natural risk hedge whereas any other integration is not a risk hedge.

**Mr GUTWEIN** - We'll leave Transend out of it. What discussions at board level have you had about the potential for reintegrating Aurora?

**Dr CREAN** - None. We're a generation business.

**Mr BOOTH** - But you also just said you're also vertically integrating by buying a retail business in the NEM.

**Dr CREAN** - Because of our involvement in the national market; we've explained that.

**Mr BOOTH** - You're a gentailer.

**Dr CREAN** - All right.

**Mr GUTWEIN** - Just on Momentum, I wanted to look at revenue and expenses.

**Mr ADAIR** - I think Mr Booth's comment was slightly tongue-in-cheek because I think the ACCC would have a lot to say about our being integrated on such a basis within Tasmania.

**Mr GUTWEIN** - Not particularly, on the basis that it was going to stymie competition but this competition has had 10 years to turn up and it hasn't, has it?

**Mr ADAIR** - I am just saying primarily from the start that they have seen they are clearly seeking to promote competition. We are competing effectively -

**Mr GUTWEIN** - Where it is realistic and achievable - you know that as well as I do.

**Mr ADAIR** - Let me come back to the question that I was seeking to answer. It goes back to the points you have raised about these controlled entities. Momentum is performing extremely well. If we took out the cost of acquisition of customers, it would be making a profit. Let us be clear about that.

**Mr BOOTH** - But that would have been an asset on your books, wouldn't it, the customer bonus, not something you write off?

**Mr ADAIR** - No, we do not, we expense it as we go along and I think that is a very prudent accounting policy.

**Mr BOOTH** - Handy.

**Mr ADAIR** - No, it is not handy, it is an acceptable accounting policy. If it were not an accepted account policy, you would find the auditors would take exception to it.

**Mr BOOTH** - I didn't say it was not accepted, I just said it was handy.

**Mr ADAIR** - The accounts represent a true and fair view and that is what we are after. When you raised Bell Bay Power, remember this is not a going concern. We are preparing to demolish it and wind it up.

**Mr GUTWEIN** - I accept that.

**Mr ADAIR** - So you do not say it is not doing well.

**Mr GUTWEIN** - The point is I did not say it was not going well, I said you have now increased the provision for demolition by 50 per cent, from \$12 million to \$18 million. So you are expecting that that business is now going to cost \$18 million to dispose of. Is that right?

**Mr ADAIR** - That is correct.

**Mr GUTWEIN** - That is exactly the point I was making.

**Mr BALCOMBE** - That is a worst case. We have had some discussions with government regarding the jetty. It is a great asset.

**Mr GREEN** - We might leave it there as an asset.

**Mr BOOTH** - Sell it to Gunns or something?

**Mr GREEN** - We could do, who knows?

**Mr BOOTH** - Have you had any discussions with Gunns about that?

**Mr GREEN** - I have not had any discussions with Gunns about the jetty but I thought it might be good if we want to expand the aquaculture industry in the Tamar, for example. It could be an opportunity for that. What do you have against the aquaculture industry?

**Mr BOOTH** - Where is your business case? Not much point if you are going to pollute Bass Strait with toxic effluent from the pulp mill, is it?

**Mr GREEN** - The other overarching point, with respect to the ACCC and our entering the NEM, would mean that the Aurora and Hydro position was well thought through at that stage and would not be allowed.

**Mr GUTWEIN** - I want to finish off on Momentum. Can we get revenue and expense operating numbers?

**Mr BALCOMBE** - I can give you those now, if you would like, Mr Gutwein. Budgeted revenue for the financial year 2011 is \$240 million and it is budgeted to make a small profit.

**Mr GUTWEIN** - So expenses are?

**Mr BALCOMBE** - They are \$240 million. Mr Adair made reference to those acquisitions costs and they are about \$5 million, so if you excise those the business would make a profit of \$5 million.

**Mr GUTWEIN** - What equity did you put in? Was it around \$50 million?

**Mr BALCOMBE** - It was \$51 million.

**Mr GUTWEIN** - What sort of return are you looking for, after expenses?

**Mr ADAIR** - We are looking for it basically to be a viable business and in that sense it gives us the capability of growing within the National Electricity Market and growing consistent returns on that. We are seeking over time to bring down what is known as the 'cost to serve' there so that this will be a very healthy business. If you look at \$5 million now on that basis, it would appeal to some of the larger players in the marketplace to buy, given the customer base we have created.

**Mr GUTWEIN** - I guess that was the question. Are you looking for a 10 per cent return on the equity investment, are you looking for a 20 per cent return, where do you set the parameters and what are you hoping for?

**Mr ADAIR** - I think we are looking for a healthy profit contribution -

**Mr GUTWEIN** - As measured by?

**Mr ADAIR** - As measured by your margin and as measured at EBITDAR level. You do not have a large amount of capital tied up in this so EBITDAR would be the appropriate measure.

**Mr BALCOMBE** - Over the corporate planning period, until 2015, we are projecting that it will produce accumulated profits of around \$60 million.

**Mr BOOTH** - Can I get back to Bell Bay Power for a moment? You have noted Bell Bay Power in your annual report as being still owned by Hydro, but in the 2008 GBE scrutiny, 2 December 2008, previous Minister Llewellyn says:

'The assets will be transferred to Aurora.

**Mr BOOTH:** When?

**Mr LLEWELLYN** - Very shortly.

**Mr BOOTH** - Within the next couple of months?

**Mr LLEWELLYN** - Yes, hopefully.'

And so it goes on - we had a bit of a discussion about it.

**Mr BALCOMBE** - That is correct.

**Mr BOOTH** - Well, wasn't it?

**Mr BALCOMBE** - The Bell Bay Power Proprietary Limited company does not own anything, so all it is, is that Hydro Tasmania has an investment in a company called Bell Bay Power which divested itself of its assets as part of that transaction with Aurora. So Bell Bay Proprietary Limited in its own right does not have any assets.

**Mr BOOTH** - But that is not what we are talking about here, we are talking about the liabilities associated with Bell Bay. Bell Bay Two, I think it was.

**Mr BALCOMBE** - As part of that contract of sale, Hydro Tasmania was obliged to demolish the site.

**Mr BOOTH** - Mr Llewellyn indicated then a number of things - one was that part of the sale process was removing the liability to pay the pipeline capacity charge from 1 April 2009 through to December 2018.

**Mr BALCOMBE** - That is correct.

**Mr BOOTH** - But you still have the pipeline capacity agreement listed in your annual report.

**Mr BALCOMBE** - I do not know where.

**Mr BOOTH** - On page 53 - Other financial liabilities - 1. building.

**Mr BALCOMBE** - Page 53 of?

**Mr BOOTH** - The Auditor-General's report.

**Mr BALCOMBE** - I do not think that we are in the current financial year - you might be looking at a few years past, Mr Booth.



**Mr BOOTH** - It is 2009-10. According to the Auditor-General, they are your figures, and they are printed out of your statement of financial position. It lists a couple of things there and one of them is 'Financial liability: \$1,043, 176 billion.' That comprises the Basslink service agreement and facility fee swap, gas pipeline capacity agreement.

**Mr BALCOMBE** - I reckon that might be reflective of the comparative figure but not in the current financial year.

**Mr BOOTH** - So are you saying that these figures in the annual report are wrong?

**Mr BALCOMBE** - I am saying that the description might be wrong.

**Mr BOOTH** - Can you clarify it? I am only asking a question -

**Mr BALCOMBE** - I have clarified it for you, Mr Booth. There is no pipeline capacity agreement on the books at Hydro Tasmania as at 30 June 2010.

**Mr GREEN** - That is the answer.

**Mr BOOTH** - That might be the answer now. The question that I am asking is based on the figures that you supplied and it clearly includes the gas pipeline capacity agreement. It is contradicted by other statements that you have made in regard to demolition and site remediation liability associated with the transfer of those assets and the asterisk indicates that gas pipeline agreement did form part of the costs in 2009-10.

**Mr BALCOMBE** - Mr Booth, can I direct you to page 99 of the annual report.

**Mr BOOTH** - No, before we go there -

**Mr BALCOMBE** - This will clarify your question.

**Mr BOOTH** - Okay, you tell me the answer then.

**Mr BALCOMBE** - If you go down that list it refers to current and non-current other financial liabilities. There is no reference to the pipeline facility agreement in those. So I would suggest that is just an oversight by the Auditor-General. But if you look at why that might have occurred, you will see that the Auditor-General's statement goes back to 2006-07 when the pipeline capacity agreement would have been included but as that contract fell away in 2008-09 it would not have been included.

**Mr BOOTH** - In other words, notwithstanding the fact that the table actually indicates that it does, it does not actually apply to the 2009-10 year. There was no cost associated with PCA in that year?

**Mr BALCOMBE** - That is correct.

**Mr BOOTH** - With that page 53 again of the Auditor-General's report, you also have the figure of \$47 million for goodwill and working capital.

**Mr BALCOMBE** - Yes.

**Mr BOOTH** - Can you give us some sort of indication of what that is or a breakdown?

**Mr BALCOMBE** - That relates to the price that we paid for Momentum Energy. That is the goodwill and acquisition of Momentum.

**Mr BOOTH** - Okay. But I think that you said that you paid per customer and wrote that off in the year of purchase for the customers that you bought, would that not be the goodwill?

**Mr BALCOMBE** - No, we paid \$51 million for the business. So what we acquired for that business was that it had some customers, it had a working platform, so it had an IT system and a billing system to bill its customers, and we acquired the management team as part of that.

**Mr BOOTH** - So you paid \$47 million goodwill?

**Mr BALCOMBE** - Correct. And as I said we are projecting that it will produce \$60 million of profit over the forward planning period.

**Mr BOOTH** - What is the forward planning period?

**Mr BALCOMBE** - Five years.

**Mr BOOTH** - So you paid \$47 million for something that will produce \$67 million over the five years?

**Mr ADAIR** - It is a very good return. Paid for itself plus money left over.

**Mr BALCOMBE** - Five-year payback is what you could say there - less than five-year payback.

**Mr ADAIR** - There are very few retail businesses with a five-year payback.

**Dr CREAN** - We did very well on that.

[10.15 a.m.]

**Mr GUTWEIN** - One last question in regard to subsidiaries. RE Storage Project Holdings: how many people are employed in that, what does it do and did it run at a profit?

**Mr ADAIR** - Primarily this is a company that has been set up to deal with the eventual building of the Bass Strait islands project, because RE Storage is the storage capability that will help us regulate the current flow, so that when the wind becomes intermittent - as it will do - this is our way -

**Mr GUTWEIN** - Which it has done.

**Mr ADAIR** - Yes, which it does.

**Dr CREAN** - It's always intermittent.

**Mr GUTWEIN** - Just more so some years than others by the sound of it.

**Mr ADAIR** - That is the very nature of wind.

**Mr GREEN** - Not only that, if it gets really windy it blows the poppies over and that is a worry.

**Mr ADAIR** - That is King Island. This is the storage capability so this is not, shall we say, a going concern at the moment. It represents basically our ability to garner some revenue eventually from that project once it gets going, and that is part and parcel therefore of the Bass Strait islands project.

**Mr GUTWEIN** - One final question on Roaring 40s in regards to Waterloo - you took out a 10-year hedge or uptake agreement for Waterloo, is that right? How long ago was that? A couple of years ago?

**Mr BALCOMBE** - It was in July 2009.

**Mr GUTWEIN** - Okay, so that underpinned the business case to build Waterloo?

**Mr BALCOMBE** - That is correct.

**Mr GUTWEIN** - Why was that uptake agreement not in relation to, say, Musselroe and building a wind farm in Tasmania. Why did we go for Waterloo instead?

**Mr GREEN** - It was project-ready effectively.

**Dr CREAN** - It was not even the fact that it was project-ready. As you remember at that time, it was extremely difficult to get any deal away.

**Mr GUTWEIN** - I accept that you guys underpinned the deal.

**Dr CREAN** - No, no it was extremely difficult to get banks to back anything because of the liquidity problems with the global financial crisis. This was a smaller project than Musselroe and it was one that we could get away at that time, so we did.

**Mr GUTWEIN** - How much smaller?

**Dr CREAN** - It was one of the only ones at that time that did get away.

**Mr GUTWEIN** - How much smaller than Musselroe?

**Dr CREAN** - Musselroe is 168 megawatts.

**Mr ADAIR** - Waterloo is 111 megawatts.

**Dr CREAN** - Waterloo is 111. So it is 55 megawatts smaller. So it is 30 per cent smaller.

**Mr GUTWEIN** - Was consideration given at that time to whether or not Musselroe should be backed instead of Waterloo?

**Dr CREAN** - Yes, it was; it was a great consideration, but the predominating factor was that we could not have got Musselroe up.

**Mr GUTWEIN** - What are the capital costs; how much did Waterloo cost to build?

**Dr CREAN** - Musselroe was \$450 million; Waterloo was about \$380 million.

**Mr BOOTH** - You have missed your cue to blame the Liberals for not supporting the Greens' amendment to the RECs stuff that went through the Senate last year to fix this problem up.

**Mr GREEN** - I have done that to death, you know that.

**Mr BOOTH** - It is your opportunity for another lash out at them because they have to accept responsibility for that. Had they supported the Greens' amendment we would have actually had Musselroe built.

**Mr GREEN** - And we still would have had a nice little business working up on the coast.

**Mr BOOTH** - That is right.

**Mr GREEN** - But anyway that is history now. It took Labor to fix it.

**Mr GUTWEIN** - So in regards to Musselroe, what was the risk to Hydro of taking on board Musselroe instead of Waterloo because as we all know that Musselroe project in Tasmania would have been a very useful project to have been built over the last 18 months.

**Mr GREEN** - What about the wind speeds though?

**Mr GUTWEIN** - Well, if you want to talk it down that is entirely your business.

**Mr GREEN** - You have done your best already to do that.

**Mr GUTWEIN** - That is entirely your business.

**Dr CREAN** - The fact is there were two in play. The Waterloo one was far easier to get away. There was significant difficulty in financing Musselroe because of the size.

**Mr BALCOMBE** - I think basically that is it because if you are talking about financial markets at the time they only had the appetite for a project financing deal the size of Waterloo. They were not prepared to go to a project financing deal the size of Musselroe so -

**Mr GREEN** - Can I also make a point with respect to this. On becoming minister I asked exactly the same questions as to why it was South Australia versus Tasmania.

**Mr BOOTH** - You must have read his mind, Peter.

**Mr GREEN** - I have been convinced, given the circumstances at the time that it was the only decision that we could effectively make to get a project away at all and so, that is the end of the story. Beyond that, of course, we are doing our level best now, particularly with respect to

understanding the REC prices and where they are going, to get Musselroe away. I have put it to them that that is what I want to see happen, and provided it stacks up that is what we are working towards.

**Mr GUTWEIN** - Do you expect the Federal legislation that has been introduced is going to fix the problem of splitting the RECs?

**Mr GREEN** - It will go a long way it would seem, an improvement in the REC prices which is about 37 -

**Mr GUTWEIN** - That is dropping the retail.

**Dr CREAN** - It has fluctuated, it is around 35 to 37, but we expect it to go up to the level required to get a commercial wind farm away because -

**Mr BOOTH** - About 50?

**Dr CREAN** - It is probably between 40 and 50, but by definition that has to happen because it is a mandated purchase by retailers. The complication has been, as you know, that the new scheme originally included solar hot water and that went gangbusters, which was not a bad thing in itself except it created a surplus of RECs in the system which suppressed the price. Now they have split it.

**Mr BOOTH** - We would have blocked the amendment and the Senate would have fixed it. Then you could go back and talk to your mate.

**Dr CREAN** - Now there is a large scheme and a small scheme. So they have been separated. So the large scheme will operate as the old MRET did. So we expect with supply and demand and the mandated nature of the scheme that the RECs will rise next year to a price that is consistent with the commercial return for wind farms.

**Mr GREEN** - What is it by 2020, the amount of megs they want?

**Mr ADAIR** - It will be equivalent to 42 terawatt-hours. That is 20 per cent of the energy output.

**Mr GUTWEIN** - This is obviously a very important question for the north-east community, which is struggling at the moment. When do you expect to be in a position to achieve financial closure and start construction? Is there anything that you can do to bring forward that project on the basis that you are confident of the REC price fixing itself next year?

**Mr ADAIR** - I think that the important point is that there is a lot of work to be done in finalising the contract prices for building the wind farm, and once you have those you then have a basis to go to the banks to seek finance, and those prices are held for a period of approximately six months which will allow you to get your financing package together. So that is a natural sequence of events. We are in the process of that negotiation at the moment and that means that we will be able to finalise the cost base. We will then be able to approach the banks for the appropriate financing package and we believe we would be at a financial investment decision around at the end of Q1.

**Mr BOOTH** - So you had all of those things factored in when you started in the first place but then the RECs destroyed the business case, is that right?

**Mr ADAIR** - Clearly, the uncertainty on the revenues is the critical thing and, as you rightly asked at the start, what are the investment appraisal decisions, what is the income expectation, the revenue received from this, and what are the factors that affect it? Therefore, the uncertainty is what REC price we are likely to achieve. I think the Chairman has articulated very clearly that there is now the separation of the small scheme and that starts from 1 January, and you will appreciate that some of the best sites have already gone in terms of wind farms, so we will be getting to see the REC price trend upwards.

**Mr BOOTH** - Yes, but the point I was making is that you have already had all those quotes and costs before you drove the stake in the ground, presumably and then ceased construction because of the RECs issue. Are you expecting those costs to be any different from what you already had?

**Dr CREAN** - The RECs issue was one issue, as I explained before; the global financial crisis and lack of liquidity was the overwhelming issue at that time. My view all along has been that the REC price, given the Government's commitment to this scheme and what it is to produce, has to come up to the commercial price necessary to build a wind farm. That has been my view all along, but there was this anomaly. It would have even been at that level had they not put solar hot water in. That was the anomaly that was created and we did warn them against that.

**Mr GREEN** - And then New South Wales subsidised it.

**Mr BOOTH** - The Greens moved an amendment in the Senate to try to fix that.

**Mr GREEN** - That is true. I notice Groomy has dropped off the feed-in tariff issue.

**Mr GUTWEIN** - We have never called for one; it was just a debate on it.

**Mr BOOTH** - Just getting back to the design and construction of the Musselroe project, you are waiting to get some costs in now. Is that because you had to put them all out to tender again or you never had the full costings in the first place?

**Mr ADAIR** - Until we were in a position where we had some certainty, so we had some initial costings but now we are asking for a firm price that can be held for a sufficient period for us to get the financing package.

**Mr BOOTH** - But you have made a substantial start on the project out there.

**Dr CREAN** - We are very confident about the pricing. The other thing that is positive is the value of the Australian dollar.

**Mr BOOTH** - The question I am asking is: did you have all of the costs, the contracts signed on the dotted line for the full costing of Musselroe, before you stuck the first peg in the ground and substantially commenced that project? There is a lot of money tied up on the ground there and you say you are now getting final costings on the total project but did you have them before you started or did you not?

**Dr CREAN** - We had the view about all the cost components, and there are a number of variables that you have to keep an eye on. One is the manufacturers, the supply and demand in their situation; the value of the Australian dollar; the REC price; and what sort of financial deal you can get. There are four main parameters.

**Mr BOOTH** - So the answer is no.

**Dr CREAN** - No. We had been doing market surveillance all the time. This is what we do with all our wind farms before we put them to the business case. The opposite would be to say, 'Let us not put a stake in any ground on a wind site until we sit down on this day'; this is all preparation. Taking your point to its final conclusion we would not have done any development assessment. We got that done and that was a cost.

**Mr BOOTH** - No, that is not my final conclusion. The question was fairly simple and I think you are being a bit defensive about it. What I want to know is: did you have a fully constructed and completed business case, based on real costs and real project time lines, when you started? You have spent considerable money at Musselroe so far - how much?

**Mr BALCOMBE** - It is \$20 million.

**Mr BOOTH** - Is it reasonable to say - setting aside the regs which you said were not the only cause - it was a bit of a wish and a prayer?

**Mr GREEN** - No. The site has been assessed and -

**Mr BOOTH** - Yes, but you have spent \$20 million and you still do not know how much it is going to cost.

**Dr CREAN** - The process we have followed at Musselroe is exactly the same process we have followed in all the other wind farms we have built. They have all been built and are successfully returning on equity and it will be the same with Musselroe.

**Mr BOOTH** - But the expectation of Musselroe was that when you commenced the project it would be finished. I have never heard that you did not actually have the completed project costs and the tenders in and so forth.

**Dr CREAN** - It became clear because of the collapse in the REC price at that time, and the global financial crisis where we could not get liquidity.

**Mr ADAIR** - You will have cost estimates available but there is a big difference between having a cost estimate and a firm contractual price, so what we are asking for now are the contracts ready for signature with a price that is held valid for sufficient time for us to raise the finance.

**Mr BOOTH** - But you never had those costings before you started the construction work?

**Mr ADAIR** - No, but we had reliable costing estimates, and that is the point.

**Mr GREEN** - And a history in building projects and a strong relationship at that time with a wind turbine manufacturer. A whole range of different scenarios existed then.

**Mr ADAIR** - That is a normal position, Mr Booth. You get detailed quotations which are not expected to vary much. We had those at the time we were working out the basic economics for Musselroe and they would indicate that it is worthwhile.

**Mr BOOTH** - Yes, but at the moment you have the greatest unfinished project since the Tower of Babel sitting out at Musselroe, which you have commenced and spent \$20 million on.

**Dr CREAN** - Would you want us to start it with a REC price of \$15?

**Mr BOOTH** - Absolutely not and that is the whole point I am making. With prudent due diligence I would have thought - and I accept the REC thing is a massive blow.

[10.30 a.m.]

**Mr GREEN** - In terms of really good wind sites around Australia, it was competitive with respect to actually having a footprint on them. So it is important that we had a stake in the ground on that site.

**Mr GUTWEIN** - When Hydro senior management and its board were looking at the benefits of building either Waterloo or Musselroe, and when you realised that there perhaps was not the appetite in some of the financial markets for a project which was slightly larger, did you go to government and discuss with government what opportunities there might have been for assistance to bring that project to fruition in Tasmania first?

**Dr CREAN** - No, we didn't. It was always known, though, that because of the difficulty in getting finance because of the GFC, if it was ever going to get up then you had to have other funds from somewhere.

**Mr BOOTH** - You are always willing to accept a donation from the Government for it.

**Mr GUTWEIN** - I suppose that is the question I am asking. When faced with a situation where you were going to build either a \$300 million wind farm in Waterloo in South Australia or a \$400 million wind farm in Tasmania - and you have said that was the decision and you actually looked very closely at it - did you go to government and say we are going to spend money in South Australia because we cannot put the case together, because there is a shortfall or we need to be underwritten to this extent, or did government come to you and ask that question?

**Dr CREAN** - They were aware what sort of proportions would be required, but \$100 million is a big amount.

**Mr GUTWEIN** - But they did not even have the discussion?

**Dr CREAN** - Remember this is Roaring 40s, not Hydro Tasmania. It is 50 per cent Hydro, 50 per cent CLP. I do not think any government would be in a mind to give \$100 million away, a free kick, to a private company. So that was a complication -

**Mr GUTWEIN** - But what made the business case for Waterloo was that Hydro were prepared to take an off-take agreement and sign that. Is that not fundamentally what gave the financiers of the project the confidence to proceed, that you guys were prepared to lock in - as Hydro - to a long-term -



**Dr CREAN** - That was one aspect. The other aspect was the size of the project and they were not prepared to do a \$450 million project - simple as that. In the end there were five or six banks that -

**Mr BALCOMBE** - I think we need to be clear on the off-take. We were only there for 50 per cent. Our partner, CLP, has 50 per cent off-take on Waterloo wind farm.

**Mr GUTWEIN** - On the basis of how important a project of that size might have been to the State's economy, it surprises me that at a government level and at a board level there were not discussions about what might be possible or would need to be done to bring this project to fruition and build something here as opposed to South Australia - on the basis of where we were at the time with the GFC.

**Mr GREEN** - Strategic, prudent management and the inability to get it away -

**Mr GUTWEIN** - But you never even had the discussion.

**Mr GREEN** - It was right at the time there was an equity injection into Hydro.

**Dr CREAN** - The Government was aware that we could not get Musselroe away but could get Waterloo away. There is a \$100 million difference.

**Mr GUTWEIN** - I do not want to labour the point but did anybody from government come to you as chairman - the previous CEO is not there to answer the question - and say, 'You are going to build a \$300 million investment in South Australia. We have a \$400 million investment sitting here in Tasmania, so why are you going that way?'

**Dr CREAN** - Absolutely. We had a number of discussions with the former minister. We met with the minister once a month and we had a number of discussions. When Bryan came in he asked the same questions but we did have -

**Mr BOOTH** - That would have been a Dorothy Dixier, wouldn't it?

*Laughter.*

**Dr CREAN** - those discussions with David Llewellyn on several occasions.

**Mr GREEN** - I said at the time, given the footprint we had there and that Hydro had made a prudent, strategic decision with respect to Musselroe, that I wanted to see that project get away. It was explained to me exactly what the circumstances were in terms of the decision-making. It was also explained to me what needed to occur at a national level to allow for the REC prices to get to a point where the project could get away. That hadn't even happened at the stage when I first became minister and those changes have since happened and it is improving, so we are on a path towards it. The CEO has just indicated that he expects to make that decision in the first quarter of next year, and if there is any way we can bring it forward certainly that is what we will be doing.

**Mr GUTWEIN** - Coming back to the Hydro's finances as the parent company, I wonder if we would start at the top and talk about board and senior executive remunerations?

**Mr BOOTH** - Can we stay on Musselroe for a minute? In regard to the FCAS requirements of Musselroe, who will provide them - it's likely to be Hydro, I guess?

**Mr BALCOMBE** - Sorry, what is FCAS?

**Mr BOOTH** - Frequency control ancillary services.

**Dr CREAN** - That's all been sorted out by the regulator now - OTTER.

**Mr BOOTH** - In terms of price?

**Dr CREAN** - Basically the difference is that we are the provider at FCAS. At the time we didn't know Tamar Valley Power Station wasn't a provider but nevertheless we are the provider and the new regulations mean that all purchases in the spot market get an opportunity to enter into a hedge arrangement, which in fact is available but not an obligation, prior to the regulator's assessment.

**Mr BOOTH** - But it's a FCAS arrangement rather than a hedge?

**Mr BALCOMBE** - They are actually hedging their FCAS price as part of that arrangement, so there is a contract. They are insulated.

**Mr BOOTH** - What I'm interested in is the actual physical facility to provide the FCAS - so Hydro now is the only one that will have to provide it.

**Dr CREAN** - Well, anyone can do it - Tamar Valley can do it, but we know we do it.

**Mr BOOTH** - But you said you didn't realise that they were not a provider of FCAS.

**Dr CREAN** - No, under the new plan.

**Mr BOOTH** - So they won't be able to provide it?

**Dr CREAN** - No, they can provide it.

**Mr BOOTH** - Okay. What difference will that make? Will that provide a competitive environment for FCAS and will potentially -

**Dr CREAN** - That's up to them. All we know is that we do provide it. You will have to ask Aurora that.

**Mr GUTWEIN** - In fact Aurora has been asked on a number of occasions about the situation. I note in your submission to the regulator in regard to FCAS that Hydro made the point that it was concerned that Aurora had taken no risk-management strategy, no hedge had been put in place when it started up AETV, and one of the conclusions that Hydro had drawn was that it was either incompetent or was seeking to end up with a situation where the regulator would have to intervene.

**Dr CREAN** - No, the assumption was that they provided their own.

**Mr GUTWEIN** - This is what you submitted to the regulator, and I thought it was quite interesting that you thought that Aurora might strategically be working towards this. The comment from Hydro was that there was 'no real significance' about it. This is from April 2009:

'These would not have been viewed by market participants as anything other than the market at work but for Aurora's decision not to have any FCAS capability and clearly not to have any risk-management strategy in place other than to turn this into a regulatory debate'.

Do you think that's what the intent was?

**Dr CREAN** - No, I don't think so; I don't think that is saying that. We are happy with what the regulator has come up with.

**Mr GUTWEIN** - But what is that saying, Dr Crean?

**Dr CREAN** - I think it is saying -

**Mr GUTWEIN** - It is from Hydro.

**Dr CREAN** - That's right, but it makes the two points about Aurora, that it can have FCAS and it can have risk management.

**Mr GUTWEIN** - And it did neither.

**Dr CREAN** - It did neither, but maybe the other consequence they hadn't even thought about, I don't know.

**Mr GUTWEIN** - Do you seriously think that?

**Dr CREAN** - Why would you expose yourself?

**Mr GUTWEIN** - This is why I am asking you, because Aurora -

**Dr CREAN** - Just so you might get the regulator to intervene? It doesn't make sense.

**Mr GUTWEIN** - Well, why would they expose themselves? Is it just that they got it wrong, are they incompetent?

**Dr CREAN** - No, we mentioned the two issues. It is not for us to comment on risk-management policies or physical provision of energy of another company. We look after our own.

**Mr GUTWEIN** - But with the greatest respect, you have commented on it.

**Mr ADAIR** - There is no such assertion. I think the expectation is that FCAS facilities can be bought in the marketplace, it can be contracted for, or if you have the generation capability you can provide them yourself.

**Mr GUTWEIN** - So why didn't they?

**Mr ADAIR** - Well, that is not for us to speculate. We are merely commenting on the fact that there are two ways of providing it and what they chose to do is completely their own decision.

**Mr BOOTH** - But what it has resulted in is that it has meant that, to a degree, Hydro's flexibility has been neutered by this new arrangement where you have a determination on the price for gas and you -

**Dr CREAN** - It hasn't neutered us - what do you mean?

**Mr BOOTH** - Well, you have \$20 million in two weeks, roughly.

**Dr CREAN** - No, that's not right.

**Mr BALCOMBE** - Can I comment on that, Mr Booth? Let us be absolutely clear on that because generators are required to buy FCAS. Hydro is a generator and it is required to acquire FCAS from the market. As well as that, we provide it.

**Mr BOOTH** - Who do you buy FCAS from, then - Hydro?

**Mr BALCOMBE** - We create it.

**Mr BOOTH** - Yes, so you don't buy them, you create them yourself.

**Mr BALCOMBE** - We buy it off the market.

**Mr BOOTH** - Off whom?

**Mr BALCOMBE** - Off NEMMCO.

**Mr BOOTH** - So provide them yourself and sell them back through NEMMCO?

**Mr BALCOMBE** - Let's be absolutely clear on this. There was about \$23 million of FCAS costs over the period to April 2009 and about \$22.7 million of that was to our own account and \$300 000 was to Aurora's account.

**Mr GUTWEIN** - Why do Aurora, then, in their annual report last year - and I will get one if I need to - make the point quite clearly, I think in the CFO's financial statement, that there was around \$8 million of losses that occurred as a result of market behaviour?

**Mr BALCOMBE** - Mr Gutwein, can I suggest you answer that question by having a look at the Aurora GBE scrutiny committee? There was quite a detailed question on that and I think the event you are referring to related to June 2009 and my equivalent in Aurora gave a very detailed answer on that and I think you ought to read that rather than our responding to that.

**Mr GREEN** - Yes, I would agree with that.

**Mr GUTWEIN** - So you're not going to buy into this in any way, shape or form?

**Mr BALCOMBE** - We can't comment on the operations of another company; you'll have to ask them.

**Mr GUTWEIN** - Well, they have been commenting long and hard on your operations.

**Mr BOOTH** - So how much of the \$22.5 million, I think you mentioned there a moment ago, was charged through to the AETV?

**Mr BALCOMBE** - \$300 000.

**Mr BOOTH** - So the AETV only paid \$300 000?

**Mr BALCOMBE** - The net impact on the Aurora energy business was \$300 000. Hydro Tasmania's position was that we earned \$23 million and paid \$22.7 million and ended up with a net position of \$300 000.

**Mr BOOTH** - So the total net cost to Aurora, absolute, was \$300 000 over that period?

**Mr BALCOMBE** - That is our understanding.

**Mr GUTWEIN** - So why did they make the point that they were commissioning the station and had to stop because they couldn't afford it?

**Mr BALCOMBE** - Again, you would have to ask them.

**Dr CREAN** - I don't know.

**Mr GUTWEIN** - That is quite extraordinary.

**Dr CREAN** - How can we second-guess how other people operate?

**Mr BOOTH** - Because effectively what you are doing is providing information that seems to contradict what was provided previously with regard to the FCAS costs -

**Dr CREAN** - No.

**Mr BOOTH** - No, not by you, but in the market there was definitely a position that Aurora was being gouged as a result of Hydro's behaviour.

**Dr CREAN** - Who said that?

**Mr BOOTH** - They complained to the ACCC, didn't they?

**Mr ADAIR** - They did, and the ACCC closed the case.

**Mr BOOTH** - Yes, because they said it was a commercial arrangement.

**Dr CREAN** - Really, you would have to ask them. Are you up against them this year?

**Mr GUTWEIN** - No, we are not, but I would love to have the opportunity to ask them after we've had this discussion.

**Mr BOOTH** - Surely you can't be saying that Aurora went to the ACCC because of a \$300 000 cost? Now, come on.

**Mr ADAIR** - Let us take these two elements separately. First of all, there is an availability to buy FCAS from the marketplace or provide it yourself. So those are two capabilities that are there and what they choose to do is entirely up to them and it is their own business the way they run that, but clearly they are accountable to the shareholders, the same as we are today. So that is the point we are making in terms of our submission to the regulator. The second point was the issue of that. Clearly there was a spike in the price. There was a formal issue raised and the regulator decided to investigate it. He investigated it and has closed the case.

**Mr BOOTH** - Yes, but if a complaint was made it must have been over more than \$300 000.

**Dr CREAN** - No-one can draw that conclusion. You have to ask them that. We were very surprised to get a letter, put it that way.

**Mr GUTWEIN** - This is from the regulator's report, just following on from Mr Booth. The regulator says:

'The impact of Hydro Tasmania's bidding strategy was that those generators that were generating at the same time paid more for FCAS than they could receive from the sale of their energy.'

One of Hydro Tasmania's competitors, AETV Power, which was generating to capture the benefits of high-priced energy, was compelled to withdraw from the market so as not to incur ruinous FCAS charges.'

Aurora had the view that you guys were hammering them into the ground, or that is the view that they have put forward publicly.

[10.45 a.m.]

**Mr BALCOMBE** - I am not sure that is the case, Mr Gutwein. I think a lot of that was created by media speculation at the time.

**Mr GUTWEIN** - 'Ruinous' is not my word, it is AETV's.

**Mr BALCOMBE** - I am not sure Dr Davis has come out and said anything about ruinous.

**Mr GUTWEIN** - This is quoting AETV.

**Mr BALCOMBE** - Is it?

**Mr GUTWEIN** - Yes, it is.

**Mr BOOTH** - Who wrote to the ACCC and complained?

**Dr CREAN** - Not us. What is the document he's quoting from?

**Mr GUTWEIN** - That is the report that was done by the regulator, in which he quotes you, as Hydro, which is where you make the point that Aurora, without a risk management in place, appeared to be looking to turn this into a regulatory debate. That is what you guys said.

**Dr CREAN** - After the event.

**Mr BOOTH** - Which is effectively what happened, isn't it, and there was a change to regulation.

**Dr CREAN** - I suppose if you have no risk management and you incur \$300 000 in costs - not a minuscule amount - you would not want to do it too often, I would think.

**Mr BOOTH** - Would you agree that it is ruinous?

**Dr CREAN** - No, it is not ruinous. How can it be ruinous?

**Mr BOOTH** - That is the point I am making, I do not think it is much for what you are providing. You have to be paid for your services.

**Mr GREEN** - In the end there was a negotiated outcome.

**Mr BALCOMBE** - We did contract prior to regulation.

**Mr BOOTH** - With respect, Minister, if there was intervention in that because of the cost to AETV, and therefore effectively the inability of that station to get into the market because of potentially ruinous FCAS, you would not have intervened over \$300 000? That is a ridiculous assertion.

**Dr CREAN** - With all due respect, it is not the minister, it is the independent regulator.

**Mr BOOTH** - But the Government was very active in making noises about it at the time. I think you went to the regulator.

**Dr CREAN** - They weren't at the time, it was the regulator and the ACCC that brought it all up, but that has been cleared.

**Mr BOOTH** - But the ACCC dismissed the case -

**Dr CREAN** - That is right.

**Mr BOOTH** - Yet the regulation has been changed.

**Mr GREEN** - Yes, as a result of that.

**Mr GUTWEIN** - This is the AETV submission made on 24 May to Mr Appleyard as the regulator:

'Hydro Tasmania has substantial market power in relation to the supply of raised contingency FCAS and consumers have been adversely affected by the exercise of that market power.'

**Dr CREAN** - We disagree with that. The consumers are not affected at all by this.

**Mr BOOTH** - They are to the degree that when they go to the Economic Regulator, when he looks at the cost justification, obviously FCAS is one of the costs of generation so in terms of price setting -

**Dr CREAN** - No, no. This was one instance in the Tasmanian market - I might add that it happens all the time in the national market - that this happened and it only affected those who purchased from the spot market, and consumers do not. It is the main purchaser from the spot market. If you are in the spot market, as occurs everywhere else in the national market, you have a risk management strategy that should hedge against these things.

**Mr GUTWEIN** - So were they talking about themselves when they were talking about consumers?

**Dr CREAN** - I do not know, but it definitely does not impact on the retailers.

**Mr GUTWEIN** - Well, it impacts on all Tasmanians on the basis that if Aurora is paying more for something than it should be then that will reduce Aurora's operating profits.

**Dr CREAN** - Not at all. As you know very well, the retail price is set. This is a cost that is absorbed by Aurora because they did not have risk management strategies.

**Mr GUTWEIN** - But then Aurora, as a government-owned business, hopefully provides a dividend to all Tasmanians. So, even though it may not have flowed through directly into the retail prices -

**Dr CREAN** - That is a very long bow.

**Mr GUTWEIN** - How can it be a long bow? Customers are paying prices -

**Dr CREAN** - Hang on, you are shifting the goalposts here. You started off by saying that the consumers are paying higher prices because of this -

**Mr GUTWEIN** - Well, AETV has said that.

**Dr CREAN** - It is not right. How can it be right?

**Mr BOOTH** - But this minister laid a regulation on the table.

**Mr GUTWEIN** - I am wondering what AETV and Aurora are up to.

**Dr CREAN** - Just make a judgment yourself. On the basis of what I have said, that retail price is regulated, this is a one-off event, so how can that impact on the retail -



**Mr BOOTH** - I will tell you how it can, because this minister laid a regulation on the table of the House to direct the Economic Regulator to take into account the long-term cost of generation to AETV. Right, Minister?

**Mr GREEN** - Yes.

**Dr CREAN** - This was the one event -

**Mr BOOTH** - The minister has just said yes.

**Dr CREAN** - How can it impact on the future if the regulator has made the decision that this will not occur again? So that one event had no impact, that is the point. We are not talking about any event before because there was none and we are not talking about any event afterwards because there will be none, we are talking about one event.

**Mr GUTWEIN** - Which AETV and Aurora have been talking about.

**Dr CREAN** - Okay, you have to ask them. I have explained the facts and you have not come up with any contrary -

**Mr GUTWEIN** - So were they wrong?

**Mr GREEN** - You will have to rely on -

**Mr BOOTH** - Hang on, he is going to make a good point here. Dig a hole, come on.

**Mr GREEN** - I am telling you this, you will have to rely on your upper House colleagues to scrutinise Aurora.

**Mr BOOTH** - We do not have any upper House colleagues.

**Mr GUTWEIN** - One of the things I did want to ask was in regard to the regulation. I note that the regulator is going to charge Hydro the costs of regulation, is that correct? In the draft pricing report the regulator says 'the regulator is of the view that it is Hydro Tasmania's practices' which seem to be in doubt, certainly in regards to your view and Aurora's view -

**Dr CREAN** - Which the ACCC has said we have no case to answer.

**Mr GREEN** - What do you not understand about being cleared and nothing to go on with?

**Mr BOOTH** - We ought to go down that track.

**Mr GUTWEIN** - The Economic Regulator obviously has -

**Mr GREEN** - Your day will come.

**Mr GUTWEIN** - a different view. The regulator is of the view and this is November actually, this is only a couple of weeks ago -

**Mr ADAIR** - And a draft report.

**Mr GUTWEIN** - Well it is still the regulator's view in a draft report, is it not?

**Mr ADAIR** - It is - to which we will respond.

**Mr GUTWEIN** - Yes, I think you might have done already. It says 'is of the view that as Hydro Tasmania's practices necessitated the regulator's declaration of the services, the costs of the investigation and subsequent costs in implementing the determination should be borne by Hydro Tasmania'. What cost would that be? What amount?

**Mr ADAIR** - I do not have a figure. I do not think it would be a large figure either.

**Dr CREAN** - We certainly have not been approached.

**Mr ADAIR** - We have not an appraisal of what that figure would be.

**Mr GUTWEIN** - Do you think that is fair?

**Mr BOOTH** - Getting back to the cost of these things, it was entirely predictable that there would be a charge for Hydro for FCAS arrangements. That is reasonable because I do not think anybody - well I am certainly not complaining about that - and it was no surprise to me that in fact that occurred. I have been warning the Government about it for years with regard to Babcock and Brown - or the original Alinta-Hydro manifestation and Alinta and then the Babcock and Brown thing subsequently. Would there have been the same sort of hysterical reaction if Babcock and Brown had actually completed that station and tried to hook it into the grid and then Hydro as the manager charged that sort of price?

**Mr GREEN** - It is all history.

**Mr ADAIR** - That is speculation again.

**Mr BOOTH** - The point I am making is the reaction is because Aurora is a government-owned entity and so is Hydro. If Babcock and Brown had been a commercial operator and it had been a properly competitive market then Hydro would have been at liberty to charge whatever FCAS they wanted to. You would tender them out, wouldn't you? If someone else wanted to supply and treat it, good on them.

**Mr GREEN** - You can run the argument or all sorts of arguments but it has been effectively resolved. The Government intervened for obvious reasons around energy security in the context of a drought situation and the global financial crisis, a whole range of things impinging upon decisions with respect to the building of -

**Mr BOOTH** - That is not the question I asked you with respect, Minister.

**Mr GREEN** - I know but you are going right back to Babcock and Brown.

**Mr BOOTH** - You give me a history lesson every time.

**Mr GREEN** - You are going right back to Babcock and Brown -

**Mr BOOTH** - Yes, that is the question I asked about Babcock and Brown, what effect that would have had on their ability to connect into the grid and whether it would have been a problem with Hydro charging them fairly for the -

**Mr GREEN** - Why don't you go back to the United States and ask why there was a global financial crisis in the first place? It is a bit like saying the lights are on, how do you explain that the globe works? Well a turbine turns up in Poatina somewhere and gives power.

**Mr BOOTH** - Maybe you should turn it off and stop wasting power.

**Mr GREEN** - You can go back as far as you want but what we are dealing with is the here and now, and the here and now says that all of these matters have effectively been resolved. Not only that, we have in place an expert panel who will review all issues associated with energy businesses, competitiveness and a whole range of other opportunities in Tasmania and that supersedes everything that you are talking about.

**Mr BOOTH** - No, it does not. It does not preclude questions being asked about it and I think it is a reasonable question, given the construction of a competitive energy market, that you had a new player come into the market and it happened to be a government-owned business. It got socked in the market when it tried to hook into it with the FCAS agreements or it certainly was talking about \$20 million and it rushed off and wrote to the ACCC to complain and -

**Mr GREEN** - Hang on, the ACCC came back and said that there was no case to answer effectively and that is the end of the story.

**Mr BOOTH** - I hope so.

**Mr GREEN** - Overarching that now is an expert panel, which you participated in -

**Mr BOOTH** - I know, you have told us about that. It was our idea in the first place so you do not need to give us a lecture about the panel.

**Mr GREEN** - I am not giving you a lecture about the panel because you have given me a lecture about a whole range of things including Basslink and whether decisions were prudent at the time - you are smarter than everybody else. You have your opportunity to go up and talk to the expert panel about all the issues you have with energy businesses now and in the past and we will see what they come up with. I am really looking forward to their report because I am very hopeful it will provide the Tasmanian people with a platform that dismisses a lot of the rubbish that you go on with, which will be good.

**Mr BOOTH** - I hope for your sake that it occurs but the question I am asking at the moment is in a competitive energy market, say there was another generator that tried to hook into the grid - what effect would that have on Hydro in terms of FCAS supply and would you expect the Government to react in the same way that they did with regard to Aurora getting into the grid as opposed to a totally independent commercial operator?

**Dr CREAN** - Again it is the independent regulator that reacted and the ACCC so that is not the Government, and let us reiterate that this was an amount of \$300 000, a one-off, and any other new operator in the market, whether it had been AETV or any private organisation would have been confronted with the same issues of risk management or take spot. We understand that there

are larger businesses that do take spot in the NEM and we also understand that in spite of this they have done very well about doing spot in general overall.

**Mr ADAIR** - I was going to say that the important point is that this situation is a one-off. We have given you the facts about what it costs Aurora and I think the Chairman's point is that clearly the regulator's determination means that the situation will not occur again and I think that is the most important point.

**CHAIR** - It is 11 o'clock so there will be a five-minute break for a cup of tea. Time is not going to be made up here so if you could come back in five minutes that would be much appreciated.

**The committee suspended from 10.58 a.m. to 11.03 a.m.**

**Mr GUTWEIN** - In the context of your assertion that the impact on Aurora would only have been \$300 000 at the time, and that this ultimately led to an ACCC investigation, is that reasonable -

**Dr CREAN** - In that instance, yes.

**Mr GUTWEIN** - What was the cost to Hydro of lawyering up and going through this process? I would suggest it is probably substantially more than \$300 000.

**Mr ADAIR** - I could not give you the exact figure but we would be happy to take that on notice.

**Mr GUTWEIN** - Can anybody give an indication? It would have been in the millions?

**Mr BALCOMBE** - Hundreds of thousands. I think it was less than \$1 million.

**Mr GUTWEIN** - So high hundreds of thousands?

**Mr BALCOMBE** - Ballpark, I would suggest around \$700 000 or thereabouts.

**Mr GUTWEIN** - So about \$700 000 to defend yourself against the ACCC for what was, as you have explained, a \$300 000 loss to Aurora?

**Dr CREAN** - We did not want to go there, we said in this forum last year - I think it was to the Legislative Council - that we would strongly defend our position. We had always acted reasonably and within the law and we would strongly defend that position, which we did, and they said we had no case to answer. Obviously had it gone on longer we would have spent more because we had to provide significant resources and information and it is costly.

**Mr WIGHTMAN** - I will direct my question to the chairman. I am interested in carbon opportunities and what the Federal Government's moves for climate change legislation will mean for Hydro Tasmania.

**Dr CREAN** - A price on carbon - whether that is a carbon tax or an emissions trading scheme with a price per tonne of carbon - will advantage Australia's largest renewable energy business, being zero-emission basically, but Hydro right in the middle of the climate change response has always strongly advocated action against climate change. One component of that action is getting a structural mechanism that we believe should be there to put a price on carbon, and that is an emissions trading scheme. I know they are talking about a carbon tax as against that, but our view is that an emissions trading scheme, a market-based scheme, is the best way to achieve it. We believe that it will come in eventually. Everyone is aware of the politics around it. We took heart in the Prime Minister saying yesterday that she will bring it on next year. That does not guarantee it will get through both Houses, but although I understand the Greens have a preference for a carbon tax, I would hope that they would also keep an open mind on an emissions trading scheme. Thinking beyond being chairman of Hydro, this is a thing that must happen in Australia and throughout the world. Amongst other things, I alluded to one earlier today about increasing substantially renewable energy by taking up the significant hydro capacity in Asia and southern Africa in particular. That is another aspect of the response, as is energy efficiency. We would welcome a price on carbon. It gives a true value to our business and makes our energy more valuable and more valuable to market as well.

**Mr GUTWEIN** - In the Garnaut report comment was made about the 'balancing opportunities' that Snowy and the Hydro would have in the national grid, or the National Electricity Market. What sort of opportunity do you think that might bring in the future for Hydro? Was Garnaut right?

**Dr CREAN** - I cannot remember the actual point he made but I do remember that he referred to those renewable energy companies, Hydro and Snowy.

**Mr GUTWEIN** - The point he was making was that effectively you could generate very quickly and switch on, switch off, and from the point of view of balancing the grid itself, that there was enormous opportunity in that respect.

[11.15 a.m.]

**Mr ADAIR** - But that is there at the moment and it is things such as FCAS that reward that capability. It is the ability to respond very quickly to deal with grid stability as units fall on and off the bars, and really that is there. I think the wider point on this is that regarding the advent of a carbon price we looked at positioning Hydro Tasmania for a sustainable future and I would say that the advent of a carbon price certainly enhances that position in a number of ways. It is a formal recognition because the market doesn't recognise at the moment the low emissions quality of the electricity that we produce. Therefore a price on carbon would demonstrate clearly the fact that we have virtually zero carbon intensity against the national average for Australia, which is 860 kilos per megawatt hour.

**Mr GUTWEIN** - Is that because of the arbitrary date - for assets built before 1990?

**Mr ADAIR** - No, it is nothing to do with that. What we are talking about now is if we look at the future we will be, certainly for the foreseeable future, Australia's largest clean energy business and that is a position clearly that we are keen to take advantage of through Momentum because we are leveraging off the unique advantage that we have.

**Mr GUTWEIN** - There have been a couple of CEOs from major energy companies who have talked about the potential for price increases in the cost of energy moving forward. Some of

them have put it, I think in one case, as high as 90 per cent over a five-year period. What modelling have you done as Hydro as to what impact a carbon tax or CPRS, however it is introduced, would have on the price that you would be able to sell your energy for?

**Mr GREEN** - Overall the percentage is quite low out to 2050.

**Dr CREAN** - If it is carbon tax it depends on the tax. If it is emission trading scheme it depends on the price per tonne of carbon. A cost of \$10 a tonne would have minimal impact on pricing but so too will it on altering behaviour. There is modelling done and \$20 per tonne produces -

**Mr GUTWEIN** - That seems to be the figure that has been talked about.

**Mr GREEN** - The advice I have is that, based on \$25 per tonne, the increase in the annual electricity costs to the average Australian household is expected to be approximately \$200-\$300 per annum.

**Mr GUTWEIN** - So that is about a 10 per cent increase in the average, about \$1 900-\$2 000 per annum average bill.

**Mr GREEN** - It is obviously weighed against what the Commonwealth would provide in terms of offsets associated with all of that. It is effectively supposed to be neutral as I understand it. That would go for our MIs as well.

**Mr GUTWEIN** - But that depends on what compensation -

**Mr GREEN** - Indeed - just a small amount of \$55 billion.

**Dr CREAN** - Whether it is that scheme that comes in or not.

**Mr BOOTH** - Roy mentioned the FCAS available to the Hydro for grid stability et cetera and the ability to turn off and on. Have you factored in the long-term maintenance costs to Hydro by using those assets in that way for FCAS, because you are now plugged into the NEM and you are providing those baseload generators effectively now to a degree to take up peak loads and so forth. I have brought up before in previous Estimates the threat to Hydro assets because they were never designed for that purpose in the first place.

**Mr ADAIR** - No, but it is a question of how you decide to allocate the proportion of your capability for grid stability purposes and bidding into the market on that basis and how much is for energy. There is a trade-off and clearly that is against how that affects our maintenance regime going forward.

**Mr BOOTH** - Yes, that's the question I'm asking.

**Mr ADAIR** - I think that primarily we are fairly happy with the mix that we have on that basis. So we do not see any massive detrimental impact from the amount of FCAS that we currently provide in the marketplace.

**Mr BOOTH** - So in terms of grid stability, how important are the major industrials like Rio Tinto, for example, with regard to its capacity to switch on and off loads to help stability?

**Mr ADAIR** - In the flexibility that you might have within a contract it does help on that score, but we are getting into very commercially sensitive areas.

**Mr BOOTH** - Yes, but how important is that to the grid stability in Tasmania?

**Mr ADAIR** - I think the most important point is that as a generator we are looking at where we would seek to be in our portfolio of capability into the marketplace and determining whether it is for ancillary services - and FCAS is frequency control ancillary services - and how much will be directly from energy, and I think we are fairly happy with the mix. Our maintenance regime means that we are fit for purpose and can operate in accordance with that portfolio approach, recognising who is likely to be providing FCAS services for the foreseeable future.

**Mr BOOTH** - Do you have a model for the future, like modelling for with and without Rio Tinto, for example, as a major industrial contract?

**Mr ADAIR** - For what purpose?

**Mr BOOTH** - Obviously for the purposes of grid stability and marketing your product. I think you've got 25 per cent of the grid going to one major industrial and part of the design of that major industrial is to provide the opportunities for grid stability. It is part of the original design.

**Mr ADAIR** - Yes, but in that area we clearly have a look at the contract we have with our major industrial customers and the necessity to ensure that there is grid stability and how that is provided. As I said, if we get into this area we are about to stray into the commercial details of what is an extremely commercially sensitive contract.

**Mr GREEN** - But there are load-shedding arrangements.

**Mr ADAIR** - Yes, there are.

**Mr BALCOMBE** - One of the important services as part of the system protection scheme arrangements that were negotiated when Basslink came in is that some of the major industrial loaders do provide that shedding on import, so when they are importing, if Basslink goes out a load can drop off and restabilise the system and that is where the major difficulty comes, it is not in the FCAS, which is fast-raise and fast-lower. They don't play in that game.

**Mr BOOTH** - No, but they were part of the original design and I am very well aware of their role and that is the question I am asking. How important are they now given that you are on the NEM and there are other generators in the system as well?

**Mr GREEN** - It is important to the State of Tasmania.

**Mr ADAIR** - They are an integral part of the way we manage our contribution to grid stability and dealing with the load requirements. I think Lance mentioned the system protection arrangements and that is an integral part of it. That is part and parcel of the package and obviously Basslink has added a complication to that and that assists greatly in the optimum operation of Basslink.

**Mr BOOTH** - Rio Tinto put an ad in the *Mercury* on Saturday effectively saying, 'Our focus is here and 55 years ago a company known as Comalco' - blah, blah, blah - 'generating economic benefits to the State, looking after our people, looking after the environment - this relationship is something we wish to continue for the next five years and well beyond.' That is a rather odd ad to be placed in the paper and maybe a bit of an ambit claim in negotiating a power price into the future.

**Mr ADAIR** - There again, I cannot comment on their marketing strategy.

**Mr BOOTH** - Given that Hydro are allowed to directly supply to Rio -

**Mr ADAIR** - Now we do.

**Mr BOOTH** - so it is obviously one of your customers that provides a return of some sort.

**Mr GREEN** - I am just pleased that they are suggesting they are going to continue on well beyond. It sounds good to me.

**Mr BOOTH** - Yes, but at some point in time you have to do some sort of analysis so the question was how important is their business in terms of providing some sort of grid stability? If they were not there with a load of that size, what would you do to regulate the -

**Dr CREAN** - That is the importance of their being there. It might be one aspect but the main aspect is that they are a high-volume customer for us.

**Mr BALCOMBE** - They are not the only provider of that service.

**Mr BOOTH** - Yes, so the answer then in that sense would be that they are not important, is that right, and that you could actually cope without them?

**Dr CREAN** - In terms of the grid stability?

**Mr BOOTH** - Yes.

**Mr BALCOMBE** - Our preference would be to have them there.

**Mr BOOTH** - For grid stability?

**Mr BALCOMBE** - As a customer.

**Mr BOOTH** - No, don't keep changing the subject. I'm actually asking about grid stability and it would make it a lot easier if you actually answered the question.

**Dr CREAN** - If theoretically they were not there you would work out ways to cope, as we have done all the time.

**Mr BOOTH** - Okay, so the question that flows from that is that if you are operating in a commercial world you have a commercial contract coming up for the supply of power which they will be able to get competition over the NEM presumably. I doubt that they would meet the price that you are paying, which I understand is about 1.4 cents per kilowatt hour.



**Dr CREAN** - For what?

**Mr BOOTH** - For the cost of power to Comalco per unit. Is it not a fact that it is about 1.4 cents?

**Mr GREEN** - You can try but we are not going to start discussing the price that one of our major industrials is paying for their energy.

**Mr BOOTH** - You are not denying that it is something like that.

**Mr GREEN** - Negotiations have taken place over a period of time and they will reach a commercial outcome.

**Mr BOOTH** - Okay. Who does the negotiation for the renewal of a contract like that?

**Mr ADAIR** - We have a commercial team that is dedicated to that. We also have independent evaluation of the terms, so there is a natural check and balance. The commercial evaluation is looking at what we expect as the price trend within the marketplace and at what other factors need to be built into the contract - for example, how you would deal with the introduction of a carbon price. That situation would then determine the broad commercial terms that we would agree.

**Mr BOOTH** - For a producer in a competitive marketplace, without any direction from the Government in that regard in terms of some social benefit or overall government policy, are you able to then go to any customer and operate in a fully commercial market without any interference or direction from the Government with regard to delivering power?

**Mr ADAIR** - Yes, but remember we are accountable for our overall performance and therefore we are looking to make the appropriate profit margin from those sales.

**Mr BOOTH** - Therefore would it be reasonable to say that, if you had an opportunity to get 25 per cent and you are spending a lot of money on other systems of generation - and AETV has come up as because there is a demand and we have fairly steep projections -

**Mr GREEN** - Energy and surety issues.

**Mr BOOTH** - Yes, but a reduction of 25 per cent in the grid or an ability to transfer it somewhere else is something. Normally you would look at a different customer base. Given the fact that power prices are going up, there is potentially increased demand, particularly with electric cars with plug-ins and so forth. I think everybody agrees that energy prices are going to go up and part of that is because there will greater competition for the energy. That is a fair thing to say. So when you offer a commercial contract like this - 25 per cent of the grid - do you have an analysis of all the other available opportunities where you might be able to retail that power or wholesale it out to someone else?

**Dr CREAN** - We do not retail because we are not a retailer.

**Mr BOOTH** - No, that is right. Do you qualify that by wholesaling it?

**Mr ADAIR** - We look at all of these elements. We are looking at the projections for the future, at the demand of the customer for the future, at the nature of the services they require and at our ability to provide that on market-based commercial terms.

**Mr GREEN** - The advice they have given me with respect to the discussions they have with our MIs generally is extremely robust. There is absolutely no doubt about that in terms of the negotiations with our commercial customers.

[11.30 a.m.]

**Mr GUTWEIN** - You are currently a GBE established under the GBE act. That act says that employment considerations need to be taken into account. What we have heard for the last five or 10 minutes is that market considerations, market price, commercial terms are being taken into consideration. Has Government provided any instruction to you in regard to the GBE act regarding employment considerations? Bear in mind that Hydro, over decades in regard to the industrialisation of this State, gave a great deal of consideration to employment. Are you currently taking into account employment considerations for the broader community when negotiating with those major industrials?

**Mr ADAIR** - Yes, and I think that is a fair question. We looked also at the ongoing sustainability of Hydro Tasmania, and the ongoing sustainability of Hydro Tasmania is affected by the ongoing sustainability of the Tasmanian economy. So clearly the critical nature of that business to the Tasmanian economy is a factor that we do take into account.

**Mr BOOTH** - Are you prepared to sell it for less than the cost of production to support the business model?

**Mr ADAIR** - Sorry, Mr Booth, but I cannot see how you can reach that conclusion from there. We are looking at a multitude of factors here and we also have a customer who is prepared to sign a long-term contract that provides certainty of revenue for us whilst providing certainty of supply for them, so a mutual benefit.

**Mr GUTWEIN** - At the moment there is discussion of movement from the GBE act to the State-owned companies act. Does that then give you greater freedoms in regards to looking at how you might arrive at commercial terms? Are there the same inhibitors, if they are inhibitors? We saw with Forestry some time ago that the board of FT seemed to completely disregard the section on employment but there is no equivalent section under the corporations act.

**Dr CREAN** - The point you are making is basically that when Hydro operates, whether it is doing contracts or whatever, we take into consideration the economic benefit of our actions.

**Mr GUTWEIN** - Well, specifically the act says 'employment considerations'.

**Dr CREAN** - We do and the best way to do that and to add to the economy and employment growth is to add value to our business. Adding value to our business gives greater returns to the Government and, of course, adds to the economic growth of the State.

**Mr GUTWEIN** - Do you discuss matters like the negotiations with major industrials with the Government and has the Government provided a view to you about the level of importance they place on those businesses?

**Dr CREAN** - It is a commercial negotiation.

**Mr GREEN** - In the discussions I have had with Hydro they have allowed me to understand at what stage the commercial negotiations are. I do not know the commercial aspects of the negotiations; all I know is that discussions are going on.

**Mr BOOTH** - So what is your modelling for long-term demand?

**Mr ADAIR** - Yes, we have. You can pick up the Australian energy market operator's report and they will tell you the forecast demand in every region of the National Electricity Market, so you can have a look at those figures. It is forecasting that there is plenty of capacity within Tasmania to 2020 on the 10-year plan they utilise.

**Mr BOOTH** - I thought there would not be any need until about 2025?

**Mr ADAIR** - Their planning horizon is only 10 years.

**Mr BOOTH** - Right. Can you give us a ballpark figure for Tasmania of increase in demand?

**Mr ADAIR** - Increase in demand is roughly about 0.75 per cent to 1 per cent per annum.

**Mr BOOTH** - Is that including projections for plug-in cars and that sort of stuff? Do you know if they have been factored in?

**Mr ADAIR** - We are looking at the development of electric vehicles and others; this is still very much in the research and development phase and is nowhere near commercialisation yet. It is a possible avenue for increased utilisation of electricity and electric vehicles would be ideally suited to Tasmania, given the distances, but will we see a massive influx of them? The answer is no. Do we see them as a material influence on demand in the planning horizon of the next 10 years? The answer is no.

**Mr GUTWEIN** - Do you agree with Transend's forecasting in regard to load? They have actually modelled three scenarios. One is a negative growth forecast of 0.47 per cent over the period to 2024. One is medium growth at 0.82 per cent and then a high growth of 2.11 per cent over that period but with some form of mystery industry kicking in around 2019 which increases the load somewhat. Have they discussed those forecasts with you at all? Or do you agree with that?

**Mr ADAIR** - No, we have access to those. Remember that Transend are a contributor to the EMO projections and they are providing three scenarios in the EMO projections anyway, very much along a low, medium and high projectile path. I think it is fair to say that their views are reflected in the EMO projections. But there is no need for us to materially change. I think that point you have asked, do we take account of demand, the answer is, yes. We clearly look at what the likely influences are and therefore how our customer base might change over that period.

**Mr BOOTH** - So if there is no need for additional capacity until 2020, if we accept that date, why would you proceed with Musselroe then, or is that factored in as part of that and no need for an increase?

**Mr ADAIR** - That is factored in, that is already in the EMO projections. So they are assuming that that goes ahead.

**Mr GUTWEIN** - I want to get back to the Hydro operating statement and start to look at the parent company in a bit more detail. But one of the questions that I want to start with is 'key management personnel compensation' as it is put here. There are 11 senior managers represented here in the annual report who receive a total of \$3.6 million in remuneration. That has gone up just under 10 per cent in the last 12 months. Why is that?

**Mr ADAIR** - Sorry, what page are you reading from?

**Mr GUTWEIN** - I am on page 116. I am looking at short-term employee benefits, which I am presuming is the current remuneration package of -

**Mr BALCOMBE** - I can answer one part of that. In 2009 people above 50 years of age were able to contribute a maximum of \$100 000 as a salary sacrifice. In 2010 that was reduced to \$50 000, so part of that increase you are looking for in that short-term benefit column was a result of some of those post-employment benefits. Superannuation salary sacrifice in 2009, people are sacrificing more, the law changed and so some of it flicked through to the short-term benefits. That is a substantial amount of the change -

**Mr GUTWEIN** - That is only about \$70 000 though.

**Mr ADAIR** - We are only talking about a movement of \$300 000.

**Mr GUTWEIN** - Even with that, it is still a 7-8 per cent increase in total remuneration for the executive team.

**Mr ADAIR** - I think the issue here is that we need to employ executives who are fit for the job and this is a very large business. It is a \$700 million turnover business and for certain of those employees we always have to ensure that we are paying around about the market rates. We have an independent assessment of that carried out, and you will find that if anything we are in the third quartile of that, not in the upper half at all. We try to maintain parity with that. We clearly wish to retain staff because the cost of losing one of those key staff would be significant.

**Mr GUTWEIN** - Just on that, in paying market-based salaries, you are the new CEO; what is your package?

**Mr GREEN** - We are not going to discuss Roy's package because it is inherent in the overall figures in the annual report.

**Mr GUTWEIN** - Well, it is included.

**Mr GREEN** - That is right, it is in there, it is part of it and I believe that is as far as we need to go with the personal information of those matters, given that we are in a competitive world.

**Mr GUTWEIN** - That is rubbish. Most publicly listed companies, in fact all of them, are having significant debates about CEO remuneration at all their board meetings. In fact, a number of shareholder meetings have not backed remuneration for a number of large publicly listed companies. If it is okay for a publicly listed company to have discussion about what the CEO -

principally the most important position in the company - is being paid, why is it not good enough for the people of Tasmania, whose money is invested in this business, to know what the CEO of Hydro is being paid?

**Mr ADAIR** - Let us go back to the question you were talking about, which is what is the movement in increase? I can assure you that my salary package is exactly the same as that of the previous occupant of the position, and that has not changed for three years.

**Mr GUTWEIN** - Well, that doesn't help if we did not know, Mr Adair. There is no need to keep it secret. I might be concerned that you are being underpaid. I am trying to help you.

**Dr CREAN** - We get it assessed independently each year and he is at the low end. As he said, it is the same as the previous CEO; it has not changed in three years. The issue I have is that someone with the experience of Roy Adair, if it was publicised at the low end, could put us at a disadvantage when you compare similar positions.

**Mr BOOTH** - Well, they know now anyway. Don't expect a flood of offers, Roy.

**Dr CREAN** - At least you have picked up on the point I am making.

**Mr GUTWEIN** - If somebody was interested in Mr Adair, they could pick up the phone and have a discussion with him at any time, so keeping his package secret, which is effectively -

**Mr GREEN** - No, it is not a secret.

**Mr GUTWEIN** - It is mixed in with 11 other people. I can see no good reason why the remuneration of the CEO of the Hydro in Tasmania, a company that has been built on taxpayers' funds, should not be known. It seems bizarre to me.

**Dr CREAN** - We disagree on that. Publicising the package - and it would be publicised - alerts people to how low a pay he is on compared to others in the industry.

**Mr GUTWEIN** - I think you have just told the world that he is on a low pay.

**Mr GREEN** - I said to Roy earlier that it is a lifestyle thing, and look at the fun he is having.

*Laughter.*

**Mr GUTWEIN** - We are trying to help him.

**Mr ADAIR** - Most nights I see the cleaners coming in and if I look at my hourly rate I think it is an extremely low one.

**Mr BOOTH** - Does that mean they do not come in very often?

**Mr ADAIR** - No, they come in every night.

**Mr GUTWEIN** - Let me be perfectly clear, there is no way that I am disparaging you personally in regard to the work you do or the hours you work. Having looked at your CV, you

are obviously very well credentialled for the job, but this is a company that is effectively owned by the people of Tasmania and a senior management remuneration -

**Mr GREEN** - Why can't you be satisfied with the cost overall of the senior executives and the -

**Mr GUTWEIN** - Because all that tells me is that we have 11 people who are paid somewhere around \$300 000 each. I do not think that all the executive team is paid \$300 000 and I would like to get an understanding of what we are currently paying the senior executive of this company.

**Dr CREAN** - We have already lost one CEO before his term expired as a result of headhunting and we don't want to lose another one.

**Mr GUTWEIN** - But that is a natural function of the market.

**Dr CREAN** - I am very keen to make sure that we don't give anyone any incentive to poach our very experienced CEO, who we are very fortunate to have.

**Mr GUTWEIN** - You are the only person at this table who has been talking about how low the amount is you pay him.

**Dr CREAN** - I am the only person at this table who is Chairman of Hydro Tasmania.

**Mr GUTWEIN** - But you are also the only person at this table who has now sent a message out that you are paying him at the lower end.

**Dr CREAN** - No, you have asked the question and you have asked for a specific answer and I have told you why I do not believe it is in the interests of the organisation to have the specific package out there for our CEO.

**Mr GUTWEIN** - With respect, I do not agree with you at all in that regard.

**Dr CREAN** - Well, we will agree to disagree.

**Mr GUTWEIN** - Will you provide salary band? Going back through previous reports, not in recent years, but there used to be a banding that was provided in regard to what remuneration was paid. Will you provide a band?

**Mr GREEN** - What is the matter with the comparisons we have?

**Mr GUTWEIN** - At the moment what you have is a lump sum of \$3.6 million with 11 people being paid out of the pool. I would like to get a better understanding of what level of remuneration we are paying our senior management team and I think it is a perfectly reasonable question.

**Mr GREEN** - From a year-to-year point of view it is agreed. Bandwidths aside, from a year-to-year perspective you can understand how the remuneration of senior executives is increasing and the impact that has on the bottom line, effectively. What is the problem with that, other than

the personal information that you require which the chairman has quite rightly said could have an impact on our ability to hold on to such senior executives.

[11.45 a.m.]

**Mr GUTWEIN** - If I could just say I think the fact that the chairman has now indicated that he thinks Mr Adair is paid at the lower end of the spectrum has potentially opened up the -

**Mr GREEN** - Consultants review the situation and -

**Mr GUTWEIN** - He is paid in the bottom quartile, is I think what was said.

**Dr CREAN** - At the low end of the spectrum.

**Mr GUTWEIN** - At the low end of the spectrum.

**Dr CREAN** - That is right and it is an issue. I would not have volunteered it but you asked me a question and I had to say something.

**Mr GUTWEIN** - You have done your best to -

**Dr CREAN** - I will give you a reason, which I think is legitimate, why we should not disclose any of the packages, because the same applies to general managers as well. There is an aggregate amount there which is consistent with fair and reasonable disclosure in the accounts and -

**Mr GUTWEIN** - Which would be quite unacceptable for a public company. A publicly listed company would provide that sort of information.

**Dr CREAN** - I do not think that is the case. I am not aware that all public companies have to disclose or are required to disclose or indeed do disclose -

**Mr GUTWEIN** - There has been legislation come through -

**Mr BALCOMBE** - Listed corporations lodge in accordance with the stock exchange rules. This applies to the accounting standards and this disclosure, and the Auditor-General has signed off on that disclosure.

**Mr BOOTH** - Yes, but you are not subject to the same accounting standards, are you, as a publicly listed corporation?

**Mr ADAIR** - With respect, Mr Booth and Mr Gutwein, on this issue the real question we are asking is basically are we actually reasonably paying our executive management team. The question is whether we paying above average and the point is that we are not. We are paying, as I said, according to an independent survey, below the median figure and in the third quartile. We have to strike a balance as the minister has said between attracting people to come here - I mean I did not come here for the money, I came here clearly for the institution that Hydro Tasmania is and the potential it has for the future.

**Mr GREEN** - You are like your minister, that is right.

**Mr ADAIR** - I came here because it is a tremendous job and there is a real capability for making a difference.

**Mr BOOTH** - There is also a difference in terms of your liabilities as directors of Hydro as opposed to a director's personal liability in a publicly listed company.

**Mr ADAIR** - No, not at all. We take our responsibilities. This is a company director's position.

**Mr BOOTH** - Yes, but you do not have the same personal liability as a director of an ASIC-listed public company.

**Mr BALCOMBE** - I actually think the obligations as a director of a GBE are more onerous than a director of a Corporations Law company.

**Mr BOOTH** - But you do not take personal liability.

**Mr BALCOMBE** - Why is that?

**Mr BOOTH** - Because you operate under different rules, I understand.

**Mr BALCOMBE** - We operate under the GBE act, which actually has broader obligations than Corporations Law.

**Mr BOOTH** - Which does not include personal liability.

**Mr BALCOMBE** - I do not understand the statement.

**Mr GREEN** - He is saying that in the commercial world -

**Mr GUTWEIN** - You have joint and several liability.

**Mr BOOTH** - As a director you have joint and several liability whereas under the GBE act you do not.

**Mr BALCOMBE** - Joint and several for what?

**Mr BOOTH** - For losses.

**Mr BALCOMBE** - You are not right, Mr Booth.

**Mr BOOTH** - You might want to check that because it is my understanding that under the GBE act -

**Mr BALCOMBE** - I am not a lawyer but I have never heard of directors having joint and several liability for -

**Mr BOOTH** - They have liability and you know what I am talking about.



**Mr BALCOMBE** - That is the whole point of Corporations Law. You form a corporation to protect people from liability. Partnerships you have joint and several liability.

**Mr BOOTH** - Just so that you understand the point that I making is under the GBE act you operate under a different set of rules than you would if you were under ASIC rules for publicly listed corporations -

**Mr BALCOMBE** - I do not agree with you, I am sorry. And I am not sure you are right.

**Mr BOOTH** - So you accept personal liability as a director of the company then for any -

**Mr BALCOMBE** - No director accepts personal liability.

**Mr BOOTH** - Yes, they do under ASIC rules if you have a look at publicly -

**Mr BALCOMBE** - I choose to disagree with you, I am sorry.

**Mr BOOTH** - You might be wrong, too. It is not a matter of whether you choose to disagree.

**Mr ADAIR** - Mr Booth, can I say what is the difference between form and substance here. I have been a director of a listed company and I take my responsibilities exactly the same and I would say, in fact, some of the reporting obligations are far more onerous but in terms of carrying out the duties, not an iota of change in the stewardship.

**Mr BOOTH** - Just to make it clear I was not actually suggesting that at all. I am just pointing out the fact that there are some differences in terms of the actual legal requirements.

**Mr ADAIR** - Okay. I think this is the most important point for the shareholders of Hydro Tasmania, is that we take those responsibilities absolutely comprehensively on board.

**Mr BOOTH** - I did not imply or suggest that. I was just simply pointing out that there was a difference there.

**Mr GUTWEIN** - So there is no chance at all that you are going to provide information to this committee on Mr Adair's salary?

**Dr CREAN** - I have explained our position.

**Mr GUTWEIN** - Can I ask then of the senior executive management team, does everybody receive the Hydro discount on their power?

**Mr BALCOMBE** - I certainly do.

**Mr ADAIR** - I think the answer is, yes, except me.

**Mr GUTWEIN** - Do board members receive the discount?

**Dr CREAN** - No.

**Mr GUTWEIN** - So the chairman and the board do not but the rest of the senior management team do?

**Dr CREAN** - Yes.

**Mr BOOTH** - Can I move on to Basslink?

**Mr GUTWEIN** - Yes.

**Mr BOOTH** - Could you detail a full cost of Basslink over the year, like facility fee, the total costs of Basslink?

**Dr CREAN** - The last financial year we had a facility fee of \$84.9 million and that was the full facility fee for Basslink. Are you after the revenue?

**Mr BOOTH** - Yes.

**Dr CREAN** - As I indicated in the beginning, we are able to use Basslink in a fully flexible way, maximising export income and net exporting around \$32.5 million. Net import income was around \$26 million. As a result of Basslink, compared to the situation when we did not have Basslink, we have a financial gain in that we are able to prevent spill in the northern headwaters and that is a value of \$15 million and -

**Mr BOOTH** - Sorry to interrupt you there, could you have used that spill instead of those pumps and stuff up through the dam storage systems rather than just letting it run down?

**Dr CREAN** - No, we do not have pumps at all. Snowy does.

**Mr GREEN** - Not a bad concept point.

**Dr CREAN** - But it is expensive, it does not work because our average price of sale is not as high as Snowy's, which is a peaking business and they can afford to do it but we cannot.

**Mr BOOTH** - I was looking at the differential and facility fee. You have a fair bit of money to get it out of the State.

**Dr CREAN** - We made a significant saving when we were using gas and instead of using gas we were able to import the same amount. So the saving there is \$25 million a year compared with the years when we had gas.

**Mr BOOTH** - That is on the old Bellway thermal, do you mean?

**Dr CREAN** - Yes.

**Mr BOOTH** - So how many megawatt hours did you ship out?

**Dr CREAN** - We exported 633 gigawatt hours and this is into the spot market.

**Mr BOOTH** - The total over Basslink.

**Dr CREAN** - Yes and we imported 1 681 gigawatt hours.

**Mr BOOTH** - 1 681?

**Dr CREAN** - Yes.

**Mr GUTWEIN** - Why would there be a difference between what Transend reports and what you are telling us there?

**Dr CREAN** - What are they reporting?

**Mr GUTWEIN** - They were reporting the total energy they transmitted within Tasmania, including export, at 11 658 gigawatt hours and then within Tasmania they transmitted 10 946. So the difference over Basslink is 712 gigawatt hours. Why would that be different?

**Mr BALCOMBE** - There is wind.

**Mr GUTWEIN** - But this is over Basslink.

**Mr BALCOMBE** - No, sorry, if you think about the difference and what that does - we have wind generation in Tasmania that they transmit.

**Mr GUTWEIN** - But it doesn't matter, it makes no difference. The total Tasmanian load plus export, 11 658, the total Tasmanian load without export, 10 946, so the difference is 712.

**Mr ADAIR** - The difference can be accounted for, because if they are measuring at the farm gate as against the distribution nodes clearly there will be transmission losses involved.

**Mr BOOTH** - That's a fair loss, isn't it?

**Dr CREAN** - It is a difference of 70-odd.

**Mr GUTWEIN** - So it's 10 per cent. Would you expect a 10 per cent loss?

**Mr BOOTH** - Yes, you would.

**Mr ADAIR** - No, you wouldn't.

**Mr BOOTH** - You would right up to the farm gate, surely?

**Mr ADAIR** - No, for what we are selling at the generation site clearly we have a gross figure and then the price that we sell takes account of losses on the way. What we are saying is that what is sold across the link - that is, has reached mainland Australia - is 633 gigawatt hours. It is simply, I think, a case of where you measure it. In terms of reconciling the two, I am happy to speak to Transend and give you a full reconciliation between our figure and theirs.

**Mr BOOTH** - Will we put that on notice or are you able to provide it?

**Mr GREEN** - When is Transend's scrutiny?

**Mr GUTWEIN** - We can ask them tomorrow but we will ask them the same question.

**Mr ADAIR** - It is a point of measure here, that's all we are talking about.

**Mr BOOTH** - So whatever the difference is, is line losses?

**Mr ADAIR** - I can understand how Mr Gutwein got his figure, but we know what we sold because we received revenue for it, and that's settled. Basically there is measurement at the point at which it leaves our point, so they are conveying when it leaves the farm gate.

**Mr GREEN** - I guess you can put that on notice because Roy has undertaken to reconcile that.

**Mr ADAIR** - Yes, it's easy to do.

**Mr BOOTH** - Talking about the value from Basslink and a net figure, the return in terms of the energy flow outwards was \$32.5 million net, but that is net of what?

**Dr CREAN** - It is the price and the cost of importing that back, so it has to be replaced. We export 633 out and then in order to replace that to keep the dam levels at the same place we take 633 of 1 688 gigawatts of import, otherwise you double-count.

**Mr BOOTH** - Sorry, I think you might have misunderstood what I was asking in terms of the net figure. The figure for 633 gigawatt hours, which I think the minister said averaged something like \$77 a megawatt hour, I am interested in that net price, the price of \$32.5 million raw - look at this as a one-way transmission out of the State, but that is 633 gigawatts and \$32.5 million is the net value of that, so that is net of what?

**Dr CREAN** - The gross is \$48.5 million, so that is the value of 633 gigawatt hours. In terms of the value of Basslink, you have to net it out.

**Mr BOOTH** - Okay, so the \$48.5 million was the total sales value and then you have deducted the facility fee cost.

**Dr CREAN** - No, the facility fee cost is different. We have deducted the cost of replacing that which we have exported. We have exported 633 gigawatts, so we have to replace it, otherwise our dam levels -

**Mr BOOTH** - Unless you get a lot of rain.

**Dr CREAN** - Yes, but not with average rainfall. I am happy to say it is \$48.5 million, but it isn't.

**Mr BOOTH** - Because you had to replace it?

**Dr CREAN** - Yes, it is the net cost.

**Mr BOOTH** - So, in other words, you didn't have so much surplus power that you didn't have to replace it.

**Dr CREAN** - Yes, that is right. It is like saying that the cost of our fuel is the cost of import because we have exported it back.

**Mr BOOTH** - But there could be a time to bring it back?

**Dr CREAN** - Yes, there could be, absolutely.

**Mr ADAIR** - Your figure is simply 633 gigawatt hours times the differential in price of 77 and 25, which is 52, and that gives you the \$32.5 million.

[12.00 p.m.]

**Mr BOOTH** - Does the same rationale apply in terms of the inwards then? You have 1 681 gigawatt hours coming back in -

**Dr CREAN** - And you take off 633 gigawatt hours, which is the cost of fuel, and what is left is a bit over 1 000 gigawatt hours, and the net benefit of that is what we can sell that for.

**Mr BOOTH** - Would you say then in that sense - and correct me if I am wrong because I am trying to add up these figures - if you took that \$32.5 million and \$26 million benefit and added them together, that would be the total net value of Basslink for that year in terms of what it carried?

**Dr CREAN** - No, because there's other value; those other things I mentioned.

**Mr BALCOMBE** - It's not quite that clear-cut. If you think about what the chairman has quoted we have imported more than we've exported. If you think about last year it was very wet early and then it got very dry and prices were low, so we took a call to hold back our generation. In a normal year we would normally generate about 8 700 gigawatt hours, and the year we are talking about it was 8 280-odd, so we held back our generation, imported more and built up our inventory, and fortunately it has rained on top of that so we've got good storages. There is always an inventory equation as part of your import-export dynamic.

**Dr CREAN** - I haven't taken that into account.

**Mr BALCOMBE** - Water we don't put on the balance sheet.

**Dr CREAN** - I'm just trying to draw the distinction between the cost of keeping the lights on in drought periods and the value in a period where you get average rainfall. It could be much better than this if you had more rain.

**Mr BOOTH** - Good rainfall, yes.

**Dr CREAN** - The other value proposition that I haven't measured, and it was worth about \$10 million this year, is that I mentioned the exports on the spot market, but also as a result of Basslink we buy and sell contracts in the national market and we can make money on those, and we did to the tune of about \$10 million this year.

**Mr BOOTH** - I guess what I'm trying to get to here is you either had to bring power in from somewhere, which Basslink has done, or you have more on-island generation that isn't reliant on rain. It could be wind or it could be something else, but the point is that at the moment Basslink is

effectively providing that additional power to come into the total demand in Tasmania and use that to keep the dams up to a reasonable surety level, et cetera.

**Dr CREAN** - Yes.

**Mr BOOTH** - If we can separate the figure that identifies without putting a value on drought-proofing or anything, just the raw data of the value of the energy in a net sense that was carried across Basslink, as opposed to the facility fee, because it cost \$84.9 million effectively to generate that return, didn't it?

**Dr CREAN** - That's right. That is the cost of the lease facility and that allows us, compared with if that facility weren't there, in times of average rainfall where you have full flexibility to produce this value with those components that I have mentioned, and the spill one is very important because before Basslink we couldn't do anything, we couldn't sell it, it just spilled. So what we do now, because we know we have Basslink, is predict the rainfall, if you like, and we run down the northern headwaters.

**Mr BOOTH** - That is true and absolutely you will take advantage of that. Spill is worth how much to you, in terms of -

**Dr CREAN** - \$15 million.

**Mr BOOTH** - But to do that it costs you \$84.9 million for the facility fee, so there obviously have to be some other advantages there as well.

**Dr CREAN** - Of the \$32.5 million, \$26 million plus \$15 million -

**Mr GUTWEIN** - \$32.5 million was?

**Dr CREAN** - Was the net export income, \$26 million was the net import income; that is importing at lower prices and selling at market prices, and -

**Mr GUTWEIN** - So that was your margin, \$26 million.

**Dr CREAN** - Yes - and spill \$15 million, using the spill, including RECs, so we get RECs for some of that.

**Mr GUTWEIN** - So \$73 million, yes.

**Dr CREAN** - And the saving of gas. Now, if we had had to provide that 1 000 gigawatt hours, which we did before Basslink, with gas, then it would have been \$25 million more to do that.

**Mr BOOTH** - But you don't have to do that now because you don't have that gas -

**Dr CREAN** - No, but it is a saving. We don't buy gas now; it is in our accounts as a direct result of Basslink.

**Mr BOOTH** - Yes, but somebody else on-island has a gas station and it is taking on the PCA and stuff.

**Dr CREAN** - That doesn't matter. It doesn't matter whether there was one there or not.

**Mr GUTWEIN** - Just following through from where Kim is going -

**Mr GREEN** - And keeping the lights on.

**Mr GUTWEIN** - So \$32.5 million is the net export income, \$26 million was the margin in May, \$15 million for the spill so that is -

**Dr CREAN** - \$73.5 million.

**Mr GUTWEIN** - So forgetting gas, the lease for Basslink was \$85 million?

**Dr CREAN** - Then you add in another \$10 million, which was the difference in contracts. So that is an additional \$10 million that we gained because Basslink is there.

**Mr ADAIR** - In this year, without a premium for security of supply for insurance capability, because effectively we have an insurance capability knowing that you can actually bring back power across the grid when circumstances relating to hydrology mean that you need to supplement it. In normal circumstances you would be paying an insurance premium for that.

**Mr BOOTH** - How much?

**Mr ADAIR** - Certainly into the teens on that score.

**Mr GUTWEIN** - So is that insurance premium absolutely necessary now on the basis that Aurora have AETV operating in the State? I would have thought that provides a certain backup.

**Mr ADAIR** - Drought mitigation would be covered by both elements. Remember you have 11 terawatt hours of total demand and in the drought years if that drops to seven in terms of inflows and Aurora's capability is only about three terawatt hours on top of that you are still short and therefore you need to have ability to put that in. It also means that we have that to meet our customer load - that is a factor that you bring into account. At 83.5 you are basically level without the insurance premium and the second factor that you have to take into account is that electricity prices were very low in the spot market in 2009-10 so this differential could be much wider.

**Mr GREEN** - What would be the projected scenario with the current storage levels?

**Mr BALCOMBE** - The corporate plan assumes that we hold storages around 33-36 per cent and that is at 30 June. So it has got shape over the year. At the moment we are at 47 and you would expect it to shortly stop raining, that is what normally happens, but it has been pretty good.

**Mr BOOTH** - But those surety levels were pre-Basslink, weren't they? So you can go down now to a lot lower because of Basslink.

**Mr BALCOMBE** - Yes. Our prudent water management arrangements, the way we operate is, that by 30 June we try to target at least 30. That assumes that we get average inflows.

**Mr GUTWEIN** - What sort of profit, if I can call it that, do you expect to achieve in future years with Basslink with water levels at their current level? Forgive me if I misunderstand this but it appears to me that Basslink this year has been a break-even proposition.

**Dr CREAN** - No, no, do not discount the gas. The gas is as real as any other. We were paying \$50 million as a cost for gas the year before last.

**Mr GUTWEIN** - Yes, but the year before last, you did not have the AETV in the mix either, did you?

**Dr CREAN** - No, but even if AETV was not there this is about the value of Basslink and what was there before for us. This is comparing because there was some dispute, if I could put it as mildly as that, several years ago about whether we should have built Basslink. Mr Booth was a -

**Mr BOOTH** - I loudly proclaimed that you were going to bring dirty power in here and it would be a costly expense et cetera and you have to accept, because of the hydrological changes and a risk that was not assessed properly, it is operating in reverse to the model that was supposed to operate. So at this point in time -

**Dr CREAN** - That is the point that I made, not this year.

**Mr GREEN** - We always said drought-proofing.

**Mr BOOTH** - No, you brought that in later actually if you go and look at the case, but anyway, let us not go back to the JAP process.

**Mr GUTWEIN** - When do you think you will earn significant revenue?

**Mr BALCOMBE** - Can I address that? If you look at our statement of corporate intent in the annual report you can see what our profit projections are. By 2015 we indicate that we will make a profit around \$212 million. You have to preface that on the basis that we are assuming that we get normal inflows of 8 700 gigawatt hours.

I think the thing we have to be really careful about with Basslink is that it is part of our integrated system. We do not actually look at the profitability of Basslink as a stand-alone, we treat it as part of the entire portfolio. So if it is dry we will import on Basslink and if it is wet we will export on Basslink. If prices are high in Victoria, we will export more.

**Mr ADAIR** - That is what you would expect in terms of optimum water management. It should not be judged purely on what Basslink itself does because actually it could have earned more if we had pushed more power through it.

**Mr BOOTH** - But the point being that it is a reasonable thing to look at on an annualised basis.

**Mr GREEN** - Only if you are coming at it from a negative perspective.

**Mr BOOTH** - It does not matter what perspective. It might actually be putting you under the pump to find out whether in fact the idea to go in the first place was a good idea or not.



**Dr CREAN** - But that is how I have attempted to answer it. The bottom line is that we have had the best cash flow we have had over the last financial year, the best profitability and that is predominantly because of Basslink. We would not be in that position had we been a supplier of the Tasmanian market and not a participant.

**Mr GREEN** - What did we get down to? Sixteen was it?

**Dr CREAN** - That is the other side of it.

**Mr BOOTH** - But the point is, and I don't want to have an argument here over whether in fact we could have provided energy security with other systems, Basslink was not the only way to get power into the State so let us just talk about the cost of Basslink itself.

**Mr GREEN** - We are thinking about another one, what do you reckon?

**Mr BOOTH** - Well, I would not be surprised but I hope this time you do some proper modelling and set up a link that is truly regarded as a transmission link rather than a generator. But anyway, the cost this year looks as if it is about to break even on those figures. I want to ask you again -

**Dr CREAN** - Only if you do not include gas and gas has to be included because even with AETV if we did not have Basslink we would have to have a gas facility in Tasmania to cope with the times that we experienced two years ago. The cost of gas would be very real to us. We do not have it now because we have Basslink.

**Mr BOOTH** - Okay, so the point being that if you had spent \$50 million on gas it would have actually generated some power from that as well. Are you saying that would have been a net cost on gas generation?

**Dr CREAN** - No, compared to Basslink. That is the comparison because that is what we are talking about.

**Mr BOOTH** - For the same amount of power generation -

**Dr CREAN** - Yes.

**Mr BOOTH** - Is that including the pipeline capacity agreement or the cost of the PCA take-or-pay agreements?

**Dr CREAN** - No, no, that is the cost of gas which includes any agreement -

**Mr BOOTH** - Include all of those things.

**Dr CREAN** - If there was no Basslink you would need more than AETV and we would have to provide a gas facility. It would have been a huge capital expenditure and the cost of gas as we were providing before was \$50 million in that previous year.

**Mr BOOTH** - Is the \$15 million for the spill that you have factored into there included in that net \$32.5 export?

**Dr CREAN** - No, it is an additional.

**Mr BOOTH** - I just do not understand and it might be my problem here, not understanding your methodology, but you have a net export or an export which has netted to you \$32.5 million in real dollars for the energy that you shipped out over Basslink and that was the electrons that were sold, now some of those ones generated through that spill -

**Dr CREAN** - It could be sold into the Tasmanian market - it may not have been exported.

**Mr BOOTH** - Yes, but effectively you were adding another \$15 million to the spill which I think had gone out because -

**Dr CREAN** - No, no because it could have been used in the local market. This is export. We have sold it in the local market. It is something that we get and we sell which we could not do previously and it is \$15 million more, there is no doubt about that.

**Mr BOOTH** - Well, no because -

**Mr GREEN** - And it allows the flexibility.

**Dr CREAN** - Yes, forget about export, this is Basslink. Basslink has enabled us to manage the system differently so that we can prevent spill and we sell that in the Tasmanian market. We do not export it; we sell it in the Tasmanian market so that is \$15 million extra.

**Mr GREEN** - Water that would have gone down the river.

**Dr CREAN** - Yes.

[12.15 p.m.]

**Mr ADAIR** - I think, Mr Booth, if I can come back to the point that Lance mentioned. This is a business portfolio, it has a portfolio of generation assets and it has Basslink and it optimises its income flows, looking at its water resource management. So it is not looking at the immediate profit today. It is actually looking at the enterprise value of holding that water and therefore you cannot judge this particular aspect on its own. If you go to the bottom line, the profit generated has been from operating that portfolio of assets. Some \$73 million has been generated from operating the portfolio and acquitting all of our water resource management, leaving ourselves with a storage that is conducive to optimum water managements.

**Mr BOOTH** - That may be the case but my job here is to scrutinise all of your operations. I am interested in seeing whether Basslink in itself, from the data you have provided from your profit and loss and costs and so forth, adds up to an investment that has delivered anything.

**Mr BALCOMBE** - It has delivered profit.

**Mr BOOTH** - You can set up any sort of system for generating power. It could be a dud, it could be the most expensive power in the world, and then you just turn around and justify it on the basis that it is part of an overall portfolio. I would like to ring-fence Basslink and get to the bottom of it.

**Mr BALCOMBE** - I will give you an example about why it would not be right to ring-fence it. Let us assume we are sitting here next year. I could come in and say we have recorded a \$100 million profit on Basslink. Guess what? We have just exported all our water across Basslink to generate that one-off profit against that asset. So you have made a one-off gain -

**Mr BOOTH** - And next year you would have a loss by bringing it back.

**Mr BALCOMBE** - Exactly, so what does that do to long-term value of the business?

**Mr BOOTH** - I am going to get to that because I was going to ask you what you have made every year since Basslink was switched on.

**Mr BALCOMBE** - Well, we do know that and you know why we have made some losses, but our exact point is that we run it as an integrated portfolio and we do it to maximise the unit-price value of the business. One of the things we have to be very careful of is that this is a long-term business. The storages are very volatile and we have to be cognisant of short-term opportunity against the long-term value of the business. That is why we do not run Basslink as a stand-alone asset.

**Dr CREAN** - Even on your criteria, if you add those figures up, including gas and the contract position, you have about \$110 million compared to costs of \$84.9 million - end of story. We can do better than that on your criteria in good times. In bad times, drought, it is a cost to Hydro Tasmania but it saves the State, as we have demonstrated. It saves the economy. There would have been awful consequences with blackouts and power restrictions to the many businesses that rely on power, a reliable supply that would not have been the case if we did not have Basslink over those two drought years.

**Mr BOOTH** - Or some alternative. So what are the costs?

**Mr GREEN** - Like what? Give us an example.

**Mr BOOTH** - Well, what are the costs with Basslink since the first year? You have \$84.9 million this year. Can you give us these figures from previous years or shall I put that on notice?

**Mr GREEN** - Have you not asked those questions in the previous years?

**Mr BOOTH** - Well, I am asking them now; maybe you could give a different answer.

**Dr CREAN** - In the drought years we were importing a significant amount. In 2007-08 we imported something like 2 400 gigawatt hours, but there was no net gain to that because we were madly importing to keep the storages up to just below 15 per cent so that we could keep the lights on. That was a significant benefit to the Tasmanian economy.

**Mr BOOTH** - I do not want you to become defensive but I am simply asking a question. I did not need the additional justification for Basslink. Every time I mention Basslink you go into a flurry of explanations.

**Mr GREEN** - I can tell you why that is. It is reflection of what you have said over time about Basslink. It becomes a little frustrating and that is the point I was making a while ago with

respect to the expert panel. Hopefully the expert panel will put a different perspective on it. Although we try to explain away your perspective on Basslink, day in and day out in these forums or in Parliament, you keep coming back with exactly the same analogy. I am hopeful that in the end the expert panel will provide Tasmanians with the information to understand that what you have been suggesting is wrong and that the strategy with respect to Bass Link is sound.

**Mr BOOTH** - I didn't ask that.

**Mr GREEN** - I know you didn't.

**Mr BOOTH** - So why are you going on about it?

**Mr GREEN** - Because you had a chip at him about having a rant over Basslink and all the other stuff associated with it. That is a reflection of how you have conducted yourself in the debate over time.

**Dr CREAN** - We have had a similar debate, Kim, before. We said that this is a 25-year project. Since 2006, a four-year operation, the two aspects of Bass Link have been demonstrated: maximising export/import, which we had last year and with average rainfall could be even better with greater flows; and drought-proofing. Hopefully the years ahead will be similar to this one, but who can predict. We are going to have droughts again with climate change but there will be enough periods where we get good outcomes. Now that we have AETV, unless it is a severe drought we don't carry the sole responsibility for security of supply that we did two years ago, where we were responsible for everything and it was at significant cost to us.

**Mr GUTWEIN** - As long as they don't get their nose out of joint and stop generating.

*Laughter.*

**Dr CREAN** - That would be cutting off their nose to spite their face.

**Mr GUTWEIN** - Can I bring you to page 130, the financial statistics? I would like to get some sense of the growth in operating expenses. You have here a five-year spread of numbers. There was a 15 per cent increase between 2010 and 2009 in respect of labour costs for the company. Why was that the case?

**Mr BALCOMBE** - We had a 3 per cent EBA arrangement with our staff. Momentum's workforce grew from around 50 to around 90. That has been consolidated in and that is the major driver of that increase.

**Mr GUTWEIN** - For what period was Momentum part of the mix?

**Mr BALCOMBE** - They were only consolidated from the end of October 2009 and they had many more staffing levels then. In 2010 they were consolidated for a full year and they had higher staff numbers.

**Mr GUTWEIN** - What was the EBA?

**Mr BALCOMBE** - It was 3 per cent.

**Mr GUTWEIN** - That begs the question as to why management salaries went up by 7 per cent or 8 per cent.

**Mr BALCOMBE** - The average increase in management salaries was 3.5 per cent.

**Mr GUTWEIN** - So the rest of the increase can be attributed to Mr Adair?

*Laughter.*

**Mr ADAIR** - I started on 21 June, so nine days of my salary are in there.

*Laughter.*

**Mr ADAIR** - Which was the same rate as my predecessor.

**Mr GUTWEIN** - Well, what has caused the increase in management salaries? It is just under 10 per cent, or close to a \$300 000 increase. There was \$70 000 worth of superannuation included in that but it would still mean that management salaries went up by around 6-7 per cent.

**Mr ADAIR** - You would have a full-year effect of an extra executive which you didn't have before, and I think that is the issue.

**Mr GUTWEIN** - The annual report is saying 11 and then 11.

**Mr ADAIR** - They're year-end figures.

**Mr BALCOMBE** - One of the drivers would have been one executive; the Momentum Energy executive was only in for part of the year and you have him for a full year. So that is the other driver of that number.

**Mr GUTWEIN** - So why would -

**Mr BALCOMBE** - Because we only acquired them around the end of October 2008. So in 2008-09 he was only there for part of the year and for the 2009-10 year he was there for the full year. So that is probably a substantial part of that difference.

**Mr ADAIR** - You have a full year effect in there with the salary.

**Mr GUTWEIN** - So the average annual increase was how much?

**Dr CREAN** - It was 3.5 per cent.

**Mr GREEN** - Do you want to relate that back to the employee numbers overall?

**Mr GUTWEIN** - Can you get the breakdown on that?

**Dr CREAN** - Yes, we will because we know that the employee salary has only increased by 3.5 per cent.

**Mr ADAIR** - It is quite easy to do the numbers. Primarily, if you are looking at an average salary, as you say, around \$350 000 on that year and you have only taken \$200 000, then the \$150 000 of that increase - and we are only talking about an increase for the executive on \$300 000 - we have already streamed out \$70 000.

**Mr GUTWEIN** - So there is an extra \$150 000 in there which is the part -

**Mr ADAIR** - Which is a full-year effect. Then you have perfect reconciliation of that figure.

**Mr GUTWEIN** - I would not say perfect, but we are getting there.

**Mr ADAIR** - Broad reconciliation.

**Mr GUTWEIN** - In regard to direct operating expenses, and I am on page 130.

**Mr BALCOMBE** - The same thing again, mainly due to a full year of consolidating in Momentum Energy.

**Mr GUTWEIN** - I thought this was instructive, this five-year spread. Direct operating expenses back in 2006 were only \$73 million. Today they are \$319 million. That is a 285 per cent increase or thereabouts. Can you provide some breakdown as to why operating expenses have increased by such a significant amount over that period, quite contrary to what has occurred with operating revenues which have only gone up by around 55 per cent over that period?

**Mr BALCOMBE** - I suppose one element of that is Basslink. Basslink was only commissioned right at the end of 2006. So we have had full years of Basslink in subsequent years there obviously. The other issue is that we are buying and selling more energy as a part of being in Momentum Energy. Momentum Energy is a retailer, so it buys energy and sells energy - off then in - as part of that. So it has purchase costs and those costs are built in there. Thus it is very difficult just to make a raw comparison of the 2006 business as against the 2009-10 business. It is very different because Momentum Energy is a retailer, so it buys off the market.

**Mr GUTWEIN** - Yes, I understand what you are saying, so they are buying. Can we get a breakdown then, because the annual report does not go to that detail -

**Mr ADAIR** - There is a reason for that, because clearly we would then be commercially disclosing our trading operation of our retail business, which then leaves us wide open to competitors having intelligence of how we operate and what prices are.

**Mr GUTWEIN** - Surely you could mix into that, you could provide some further clarity than the annual report and provide some cover for yourself in regard to some bundling of expenses that would not give an exact figure?

**Mr ADAIR** - We may disclose it slightly differently for the future. We could net that off the sales of goods and services. So you can take it off the total income figure. So that would then be sales of goods and services, net of the cost of electricity. So you are getting an income from the sale of electricity and therefore you deduct from there the cost of making that sale of electricity. So that is one way of doing it and what you are saying is, you would like to just look at the direct operating expenses, which do not include any form of electricity trading.

**Mr GUTWEIN** - I think that would provide further clarity in regard to what has gone on here. But I guess the question then is in regard to the 2009 figure, would Momentum Energy have had energy purchases in that year but not to the same?

**Mr BALCOMBE** - Not for a full year, it was only a part year. So it is very difficult to make that direct comparison because it is a bit of an apples and oranges comparison, particularly the further back you go. It was a very different business in 2006 compared to today.

**Mr GUTWEIN** - Back onto labour. The difference between 2009-10, apart from the 3 per cent EDA increase is effectively the cost of?

[12.30 p.m.]

**Mr ADAIR** - The full-year effect of Momentum.

**Mr BALCOMBE** - And Momentum itself has grown as a business.

**Mr GUTWEIN** - I am trying to get an understanding of the companies. The Auditor-General made the point in his report that there is not a great deal of segment reporting in the annual report. You do not have to do that but one of the things that would certainly make it easier for this committee and save a number of questions would be if we could look at some form of segment reporting, certainly more detail in regards to JVs but importantly those subsidiary companies that you have. You have bundled them all up and as we have gone through them today we have costs and losses but no real information in regards to what is occurring with those companies and differing conclusions can be drawn.

**Mr ADAIR** - I understand, but the point is that these are all public domain documents now and we are competing in the National Electricity Market and it is very important that we try to preserve what competitive advantage we have. We have a degree of disclosure here that is far greater than our private sector counterparts. I can assure you that is a fact.

**Mr GUTWEIN** - It was interesting that Don Challen, the outgoing head of Treasury, said that there was not sufficient disclosure in regards to our own government businesses and in the marketplace that publicly listed companies would provide a much greater deal of disclosure.

**Mr ADAIR** - No, they do not, I can assure you. If you look at AGL and Origin and what they disclose, you will see that it is to a much lesser extent than this. Our annual report here is far more comprehensive and that is something that you can readily test by just picking out what is on the website.

**Mr GUTWEIN** - I might have a look at those.

**Mr ADAIR** - I stand by that fact.

**Mr GUTWEIN** - In regards to that then and a comment that Mr Balcombe made about inviting some further detail, in fact I think that you might have made it. Can we expect next year then to see an annual report that does net out energy purchases, which would necessitate energy sales in relation to those purchases being netted out of revenues as well?

**Mr ADAIR** - Sure. Because the point that we have made to you as well is that we have been reducing our operating costs base progressively over the years and that trend is continuing. I do not think that you see it as clearly as you might in these figures.

**Mr GUTWEIN** - I do not think you can see it at all.

**Mr ADAIR** - I disagree, we will look at other operating expenses; they show, very clearly, a reasonable trend.

**Mr BOOTH** - I want to go back to the business with the FCAS charging issue that we did go through to some degree. I have just had provided to me a couple of media reports of the time. I am quoting here from the *Mercury* of 14 September where there is an article that states that Aurora Energy and major industrial customers -

**Mr GREEN** - It is not the one where they had 465 per cent increase in power prices, is it?

**Mr BOOTH** - No, that might have been a different one. It says here that Hydro Tasmania has been condemned by fellow State-owned company Aurora Energy and major industrial customers for allegedly abusing its monopoly market power.

They talk about how the Tasmanian Energy Regulator is considering placing tighter regulations on the power generator, which OTTER has I think, in regard to the provision of power.

**Dr CREAN** - Yes, we talked about that.

**Mr BOOTH** - Yes, that is correct. But it says here:

'Hydro charged competitors ... up to \$5 000 a megawatt hour, or \$10 million a week, for frequency control ancillary services required by generators'

**Mr ADAIR** - Are you saying that the *Mercury* is a source of actual fact?

**Mr BOOTH** - No, I am asking you that question.

**Dr CREAN** - And it definitely was not right on the 465 per cent increase in costs. They got that one completely wrong. We have given you the information for that one, the net cost was \$300 000.

**Mr BOOTH** - I appreciate that.

**Dr CREAN** - That has been, I understand, corroborated by Dr Peter Davis in his submission of last year, Lance, was it?

**Mr BALCOMBE** - I am not entirely sure when it was made but his statements have been consistent with ours, as I understand it.

**Mr BOOTH** - Consistent with regard to that. What you are saying then is it is not right, not true. Also then, what about this statement:



'The ACCC did, however, find that Hydro Tasmania's conduct had serious implications for market participants and consumers.'

How could that be if it was only \$300 000?

**Dr CREAN** - We disagreed with that. This was one instance, remember, of \$300 000. How can that have implications for consumers? We disagreed with them going ahead with the whole process. We told them, 'We have nothing to answer but we're happy to do so', and we were proven right.

**Mr GUTWEIN** - Why did Aurora do this?

**Mr BOOTH** - So that statement -

**Dr CREAN** - We strongly disagreed and we told them that. It would be a good thing if you take it up with the panel.

**Mr BOOTH** - Well, I hope you guys will too, presumably.

**Dr CREAN** - It is all settled as far as we're concerned. We have spent a heap on doing this, it was distracting and we knew we had no case to answer. We knew that. So you can understand why we're a little bit hot under the collar when we read reports like this.

**Mr BOOTH** - Just to be clear, I'm interested in getting to the bottom of what happened there.

**Dr CREAN** - We got to the bottom of it.

**Mr BOOTH** - Well, it's the first I've heard that it was only \$300 000 and in fact -

**Dr CREAN** - Yes, but we did tell you that.

**Mr BOOTH** - You told me a few minutes ago.

**Dr CREAN** - No, about an hour ago, and we spent about half-an-hour on it.

**Mr BOOTH** - But you've had since 14 December 2009 that this was out there in the public domain. I don't remember Hydro rushing out and saying it was \$300 000, but perhaps you might have done.

**Mr BALCOMBE** - Just in that regard, once we had been written to by the ACCC we were not permitted to comment on any of that aspect publicly until it had been resolved by the ACCC, so we were not in a position to make a comment.

**Mr BOOTH** - Has it been made public before that it was a \$300 000 cost? I know that the ACCC found you had no case to answer.

**Mr ADAIR** - And that is the point that we commented on. When the decision came out we said we were delighted they had come to the conclusion which backed our position all along that there was no case to answer.

**Mr GUTWEIN** - Except that the regulator did not back that position, did he?

**Mr BALCOMBE** - That is the regulator's view and we do not agree with the regulator. The regulator is a regulator and the ACCC is the ACCC and we did not want to argue a point with the regulator when in fact the ACCC was considering the position.

**Dr CREAN** - You know what all this shows? It shows a fundamental lack of understanding of how the spot market works in Tasmania and how FCAS works. That is one thing that has become very clear, and even more clear with all the things you have been quoting over the last hour or so.

**Mr BOOTH** - Yes, but the point is that OTTER has intervened as a result of this -

**Dr CREAN** - Yes, and we did not oppose that because basically it was what was available before except they have said the hedge must be offered before it was available.

**Mr BOOTH** - Right, okay, so it would be a similar cost if it happened again.

**Dr CREAN** - No, because no-one was hedged before.

**Mr BOOTH** - Right, okay.

**Dr CREAN** - It was that one occasion of \$300 000 for which they were not hedged. If they were hedged it would have cost them nothing. That's the beginning and the end of it.

**Mr BOOTH** - To make it clear, I always said that would be a problem and I do not have a problem with your acting commercially. You are not there to provide support for Aurora and I do not have a problem with that. You are supposed to be operating as separate entities so that is your commercial right. I was surprised -

**Mr GREEN** - Why did you call them 'rogue' then? Explain.

**Mr BOOTH** - If you've got half-an-hour I will detail it but we are actually in Hydro's scrutiny at the moment.

**Mr GREEN** - No, you talked about Hydro in that context.

**Mr BOOTH** - What - as being rogues? I might have been talking about you.

**Mr GREEN** - No, you were talking about them.

**Mr BOOTH** - Probably more the minister, I would say, than the actual board.

**Mr GREEN** - You were talking about them.

**Mr GUTWEIN** - But on this and attempting to get to the bottom of it and understanding it, we have heard today \$300 000 is what it cost Aurora. We know that it has cost perhaps up to \$1 million or maybe \$700 000 in legal costs to defend yourselves against the ACCC investigation. There has been a \$300 000 cost to Aurora, you guys have spent \$700 000 defending yourselves,

the ACCC has come back and said that you had no case to answer, but then the Tasmanian regulator has said that you obviously did because they regulated -

**Mr GREEN** - And guess what - the Parliament has put an overlay on that now that we have a panel of experts to look at the competitive nature of Tasmanian business and we have a regulation in place. It is all fixed up.

**Mr GUTWEIN** - It's not all fixed up.

**Mr GREEN** - Yes.

**Mr GUTWEIN** - We have had Aurora get to \$300 000, you guys costing \$700 000 and we have a regulator who says that you did do something wrong. The ACCC, which you obviously agree with -

**Mr GREEN** - And there's \$2 million that the Parliament put forward for the new committee.

**Mr GUTWEIN** - There has been a significant cost.

**Mr GREEN** - Yes, and we are just putting another cost on it.

**Mr GUTWEIN** - How did it get to this? Minister, if there was only a \$300 000 cost to Aurora, and I understand as the minister and shareholder of these companies there are Chinese walls that you have to operate -

**Mr GREEN** - That is exactly right, and we won't be discussing any of that.

**Mr GUTWEIN** - But how on earth did it get to this? The cost at this stage, both to Aurora and to Hydro in defending itself, appears to be over a million dollars for what occurred.

**Dr CREAN** - Someone complained to the ACCC on whoever complained's perception and we defended our position. That is why it happened. It had nothing to do with the Government. The Government doesn't answer to the ACCC.

**Mr GREEN** - I am making a political point. I think you are being slightly hypocritical given your support for a panel of experts to look at energy businesses and the structure of energy businesses and the way that we conduct ourselves within a small market in Tasmania and what the best mix and fit is for the future. Employing those people is costing us a lot of money as well. So what is your point?

**Mr GUTWEIN** - Well, the point is that what we've heard today is something completely contrary to what has been out there in the debate up to this date.

**Mr GREEN** - At least Mr Booth recognises that there was competitiveness within the market and they are operating within the parameters they believed were correct and they've been proven right from that point of view.

**Mr GUTWEIN** - You are minister for both of these companies.

**Mr GREEN** - That is correct.

**Mr GUTWEIN** - So did Aurora just get it horribly wrong? Was Aurora attempting to manage AETV without putting in place any protections through a hedge at all, or being prepared to generate their own FCAS and went into the marketplace completely exposed? Is that the bottom line - did they not know what they were doing?

**Mr GREEN** - No, I wouldn't say that at all.

**Mr GUTWEIN** - Well, what were they doing?

**Mr GREEN** - What I will say is they put their own position with respect to a regulated outcome and argued for that, and in the end we've got an arrangement that satisfies both them and the Hydro.

**Mr BOOTH** - Can I move on to another area now?

**Mr GREEN** - The point is you can go right back, as you tried to with respect to the GFC, to the original company that wanted to build the power station here, and what the Government was confronted with at the time, the drought. All of those issues came into play and impacted and then you simply say, 'How did it come to this?'

**Mr GUTWEIN** - Well, you are the minister; I think it is a perfectly reasonable question to ask you.

**Mr GREEN** - And I am explaining to you that there is a complexity as to the decision-making, the here and now, and the issues that were confronting the Government at the time. Those decisions, I believe, were prudent with respect to Aurora purchasing the power station and what flowed from that. I think in the end the expert panel will provide some clarity about that decision-making and as a result of that we will all be able to move on.

**Mr GUTWEIN** - Have you bothered to take the time as minister to ask for a 'please explain' from Aurora? What we have heard today is that the impact of Hydro's behaviour, which has been variously portrayed by both the regulator and Aurora as being ruinous of AETV, if it is only a \$300 000 cost then that bears explanation, certainly from Aurora, as to why they have gone down this path at the end of the day for a \$300 000 cost that has now cost this organisation \$700 000 or possibly more and still puts them in a position where, when the regulations are introduced in regard to FCAS, the regulator himself in his draft report is saying that they have to bear further costs. I would think as minister -

**CHAIR** - Mr Gutwein, can I just remind you that this is the Hydro GBE scrutiny, not Aurora.

**Mr GREEN** - Hydro has its view, Aurora has its view, they are independent of one another and you will have the opportunity - or the upper House will on this next occasion - to ask various questions of Aurora leading up to that. Of course that will be completely transparent, as is this.

**Mr BOOTH** - I want to ask a question now with regard to further energy generation on the island. You've said that the projections at least until 2020 are that there is no need for any future generation. Would that be to bring them online or to even contemplate them or do the design work for them, start construction and so on?

**Mr GREEN** - For the Bass Strait islands?

**Mr BOOTH** - No, sorry, Tasmania itself.

**Mr ADAIR** - So, mainland Tasmania. I think you are probably referring to the 1 000 gigawatt hour program. That identified potential opportunities and some of those have now been put on hold. If economic circumstances change, such as the demand-supply balance, and those projects then become economic, we can bring them back very quickly.

[12.45 p.m.]

**Mr BOOTH** - But at this time there is no intention by Hydro to do so; you are not involved in any considerations of actively pursuing any on-island generation.

**Dr CREAN** - There is Musselroe and then the Bass Strait islands, because why would we build where there is an oversupply?

**Mr BOOTH** - Well, absolutely; I am not suggesting you should, I am just clarifying and thank you for that. I was then going to move on to the Bass Strait islands and in particular Flinders Island, with a question as to whether you have considered altering full-cost reflective pricing to people who have put on their own generation on that island simply to avoid the need for Hydro to burn diesel. I think it costs about 67 cents for the cost of production on Flinders at the moment.

**Dr CREAN** - The CSO is about \$7 million.

**Mr BOOTH** - Yes, it is a big cost. Let us not then set a figure but I am talking about the cost of production over there because it is predominantly diesel which runs your baseload anyway which is pretty high and so it is one place you could isolate because it is off the grid and does not have a cable connection so it is captured by fossil fuel generation at the moment. I know that you have this Bass Strait renewable energy program going but have you looked at the value to Hydro of not having to produce that power at 67 cents? I know you get the CSO back from the Government, but wouldn't it be prudent to consider allowing everybody on that island to be part of that grid as a generator themselves and not therefore require Hydro to put in different forms of energy generation?

**Mr ADAIR** - I think the system that is being provided is the most cost-effective solution. We have had a look at what we are doing to avoid the emissions that arise from diesel by generation so the solution that is going in there is far more cost-effective.

**Mr BOOTH** - You have diesel generators there at the moment but there have been big advances in battery storage for example and other alternative generation things in the last few years.

**Dr CREAN** - That is all we are doing. At the moment no-one has proposed any other development to develop energy on either of the islands so we are responsible for it and we are converting from greenhouse gas producing, which both of them would have been doing exclusively 10 years ago, to a renewable energy solution which will, on average, give about 75 per cent renewable penetration and at times 100 per cent on King Island, which is the first one being done, and then Flinders Island in phase 2. So we think this is the best solution for the

islands and, of course, it gives us an opportunity to demonstrate a model that we believe we can adapt to any remote area anywhere in the world.

**Mr BOOTH** - Would you consider offering cost-reflective pricing? I think Hydro owns the transmission and the retailing on Flinders as well.

**Mr ADAIR** - The distribution, yes.

**Dr CREAN** - Just give us an example of what you have in mind.

**Mr GREEN** - Somebody puts up their own wind farm -

**Mr BOOTH** - There are feed-in tariffs, there are gross feed-in tariffs -

**Mr ADAIR** - There are.

**Mr BOOTH** - I am just saying that in my view full cost-reflective pricing is not a bad way to offer take-up of renewables by people who want to do it, and there is a value to Hydro in the sense that some of these things run at a loss for you so if somebody wants to replace it, your responsibility reduces.

**Mr GREEN** - There are some technical issues associated with allowing that to happen as well.

**Mr ADAIR** - There is also the intermittency of supply. You always have to have the backup capability.

**Mr BOOTH** - Yes, I know, but for every megawatt hour or gigawatt hour that is produced by somebody else it is one that you do not have to produce yourself -

**Mr ADAIR** - Yes, we do.

**Mr GREEN** - We have to have a base.

**Dr CREAN** - We are developing a system to take into account the needs of all the islands, so we cannot work on the basis that someone might come in privately, we have to manage the project according to our costs.

**Mr BOOTH** - That is what I am suggesting, whether you have looked at cost-reflective pricing so you can encourage other generators.

**Mr GREEN** - Wouldn't the scenario be that it might be a laudable thing to do but everybody then has to have the same opportunity and if you have that scenario operating providing the baseload would be extremely difficult -

**Mr BOOTH** - Well, not necessarily; you might be able to convert that diesel to gas and run them at a lower output.

**Mr ADAIR** - There is a difference. We have to make available the capacity to deal with all of the energy consumers on the island and allow for the fact that if they were putting in their own

individual means of generation, it would be either through solar or wind, and I doubt if they have a biomass that would be viable on that basis. So because of the intermittency of the supply we always need to have the maximum capacity to deal with all of them. What drives energy costs, fundamentally and particularly the fixed-cost base, is the maximum demand that you are creating the capability to deal with. Fundamentally, at this stage, we are talking about driving this one down so it is much more sustainable, and the sustainability of it comes from collective initiatives that we are putting in.

I think the most important point is that the Bass Straits islands will become a showcase for what is called remote area power supplies, and we would hope that there will then be a future business opportunity for us to roll this out to the 1.4 billion who suffer from energy poverty in remote areas whereby you can have sustainable solution. So I think the initiative is a good one and is economically viable on the basis that it has been in the grid.

**Mr GREEN** - We have received \$15.8 million from the Commonwealth to assist.

**Mr BOOTH** - I think it is good that you are looking at those projects and there are some great elements to it but I am just wondering how broadly you would look at whether you can have a disaggregated generation storage with battery storage from ring mains and plug-in cars and all of those emerging technologies. I am not saying that this is a solution but it certainly seems worthwhile. If you can have a household with its own generation capacity through some wind and some solar, they could generate a fair bit of their own energy, store it in disaggregated way but on the same ring mains so you suffer less transmission losses and the transmission lines do not have to be as big. There are a whole lot of elements there that would be worthwhile trying to factor into the system. I am wondering whether you looked at that rather than just the single point source generator with a big baseload capacity?

**Mr ADAIR** - I think we have. In terms of the overall economics, again, it is a series of individual solutions and, remember, you will not get 100 per cent take-up on that score.

**Mr BOOTH** - You might at 67 cents, if that is the cost.

**Mr ADAIR** - But there again, we then have to make available the backup supply capability and you have to remember the cost of that.

**Mr BOOTH** - But you've got that already.

**Mr ADAIR** - That's right but you have to maintain the transmission and distribution systems to deal with that capability. So there is no lowering of your overall transmission costs, the fundamental costs of transmission are all capacity-driven.

**Mr BOOTH** - You are right if you do not have storage capacity right around the ring main. That is the big difference and it's something you have not looked at yet, have you?

**Mr ADAIR** - I think we have in terms of what constitutes the optimum sustainable solution for the islands.

**Mr BOOTH** - When was that work done?

**Mr ADAIR** - This work was done when they were assessing what the mix would be between the different types.

**Mr BOOTH** - So, some years ago then?

**Mr ADAIR** - Yes, it would be.

**Mr BOOTH** - So you have not considered, say, plug-in cars as being part of the energy supply there?

**Mr ADAIR** - That means that they would also have to convert to buying electric vehicles on top of that.

**Mr GUTWEIN** - I have a couple of questions before we finish; we are finishing at 1.00 p.m. aren't we?

**CHAIR** - Yes, we are.

**Mr GUTWEIN** - What was the cost of changing Hydro's logo and livery?

**Mr ADAIR** - It was \$1 million, but it was not the cost of changing the logo, let us be clear. The current brand and the logo that went with it originated back in 1998 and the business has developed considerably since then. It has become part of the National Electricity Market, it has built Basslink, it also has the retail business now with a significant number of customers which is actively growing, and the consulting business is, we believe, quite a substantial business with more than 330 employees. So we needed a brand architecture that captured all the elements of the business so that we had an overarching brand architecture that would cover those. We looked at a business that has a \$700 million turnover and looked at the power of the brand, we went through the architecture which was based on the power of natural thinking which looks clearly at the duality of those words, and the cost of \$1 million which incorporated the new logo. On the economics of brand valuation, we get a payback on that very quickly indeed.

**Mr GUTWEIN** - The cash that you held at the end of the year seems to be particularly low on the cash flow statement compared to previous years. For a company of \$700 million in turnover and \$1.8 billion worth of assets, you have \$3 million in the bank. Can you just explain your thinking in that? I looked back over past years and it seemed to fluctuate between \$15 million and \$30 million.

**Mr BALCOMBE** - I suppose there are a couple of elements to that. We have changed our approach to borrowing and our short- and long-term debt. Looking at the market, the spreads have shortened on the shorter end, so basically in our debt portfolio the average term to maturity has shortened. That is because the guarantee fees that have been set by the government are shorter at the front end, so there is a natural shortening in portfolio. The other element is that previously we used to get an offset on our guarantee fees for the cash we were holding versus the debt we had, so it didn't really matter too much if you were holding cash and you had higher borrowings as a result, because you could net off the guarantee fees. The guarantee fee policy changed at the end of 2009 -

**Mr GUTWEIN** - So you are retiring your short-term debt with your cash?



**Mr BALCOMBE** - That is right. You didn't get the benefit of having it offset, so there was little point in holding cash. We have overnight facilities from where we can quickly draw with Tascorp, so we don't hold cash and we just draw on those overnight facilities. That is about a \$20 million facility.

**Mr GUTWEIN** - Just explain what happened to the government guarantee fees.

**Mr BALCOMBE** - If you held cash with Tascorp your borrowings were naturally higher. The guarantee fee that you had, because the debt was higher, would be offset by the cash held at Tascorp. That is no longer available.

**Mr GUTWEIN** - Has it changed?

**Mr BALCOMBE** - Yes. You no longer get the benefit of a reduction in your guarantee fee for the cash you hold.

**Mr GUTWEIN** - When was that policy changed?

**Mr BALCOMBE** - Around the end of 2009 - it may have been earlier.

**Mr GUTWEIN** - This is the first year I have seen you hold so little cash, so it surprised me.

**Mr BALCOMBE** - On the back of that we have renegotiated our facility, so we have that come-and-go facility of about \$20 million with Tascorp.

**Mr GREEN** - Chair, I take the opportunity to thank the David Crean, Roy Adair and Lance Balcombe for their contributions today.

**CHAIR** - Thank you all very much.

**The committee adjourned at 1 p.m.**